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## AN ADIRONDACK VIEW

**Suburban Experts.** Mott Chapin lives in a small town in the Adirondacks—well, our towns are small here. Asked about living there, instead of in the city where his father lived, he said, "Well, if I had stayed in the city I would probably have become a doctor like my father. He spends fifty weeks in the year working to be able to spend two weeks of each year up here. I live here fifty weeks of the year, and spend two weeks in the city—as a family duty."

Business, including the manufacture of services, is moving out of the city. People are moving out—their offices are going to follow. More CPAs are opening offices in the smaller places. The American Institute of Accountants is talking about better group insurance for the lone practitioner.

It won't be long now before—before what? Before the experts will be called to the client from the mountains, instead of vice versa!

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## Book Reviews

### Elementary Accounting (Second Edition)

By Perry Mason, George Stenberg, and William Niven. THE FOUNDATION PRESS, Inc., Brooklyn, N. Y., 1956. Pages: x + 973; \$6.25.

This is the second edition of a text which has gained favorable attention since its original publication six years ago. The authors parallel the pattern of the first edition rather closely because of their strong convictions to the basic soundness and teachability of the materials first presented.

Those familiar with the book will find major changes confined to an expanded treatment of the bookkeeping cycle, the shifting of the chapter on cash control and the voucher system from the first to the second half of the book, and the introduction of some new techniques in accounting such as the declining balance method of depreciation. The reader will also find that the questions and problems now follow each chapter which should result in less "fumbling" around. The longer problems, originally characterized as laboratory problems, are now referred to as practice problems and are retained as a separate section following the text presentation. It goes without saying that both sets of exercises have been updated but their provocative nature and thoroughness of coverage have been retained without exception.

To readers of this journal not familiar with the book there are several features worthy of comment. In the development of the bookkeeping cycle one will find the discussion well documented with illustrative accounting forms for most practical bookkeeping situations involving small and medium-sized clients. Both the handwritten and machine types are included. Of perhaps greater significance is the skill with which generally accepted accounting principles are woven into its development. Thus, accrual accounting is introduced at the outset.

Chapter 8 on merchandise accounts includes a demonstration of the "cycle billing" process which has been widely adopted in the retail field. Chapter 9 is devoted to an outstanding discussion of controlling accounts and special journals. In this chapter the most common methods of handling the controlling account system are explained, i.e., the journal entry and posting, direct posting to subsidiary ledger, and the file of memoranda as the subsidiary ledger. After chapters on the subject of payroll taxes and sales taxes, and notes and drafts, the

(Continued on page 406)

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## Book Reviews

(Continued from page 405)

book returns to the accounting cycle and  
delves more deeply into adjusting entries,  
the work-sheet, and the construction of  
financial statements.

In continuing this survey, two sections  
in the second half of the book are especially  
to be commended. Chapter 15 takes up the  
"principles" of accounting. Here the reader  
will find the controversial issue of principles  
versus conventions, doctrines, and/or policies  
well summarized.

What strikes one most in reading the  
section on cost accounting, Chapters 26 and  
27, is the completeness with which the sub-  
ject is developed. The authors go beyond  
the basic treatment of both job order and  
process cost accounting to include a relatively  
extensive discussion of departmental overhead  
rates and joint and by-product accounting.  
This section is brought to a close with a  
brief but cogent exposition of limitations and  
purposes of cost accounting.

"Elementary Accounting", second edition,  
should enhance the already excellent reputa-  
tion of the first edition. It is, of course,  
primarily a text book designed for elementary  
accounting at the freshman level, but never-  
theless the individual practitioner will find  
much of interest between its pages, especially  
in the presentation of sound theory.

MORTON F. MOSS

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### knife wound in the heart



**U**NDER THE blazing blue sledge hammer of a Chicago heat wave, the cramped, make-shift operating room shimmered like an oven, reeking of ether and carbolic. Sweat-drenched, frock-coated doctors huddled in fascination, watching deft hands reach into a human chest and expertly stitch up a fluttering wound in the redness of pulsing heart.

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## Book Reviews

(Continued from page 406)

### Case Studies in Auditing Procedure: No. 11-A Hospital

Sponsored by the Committee on Auditing Procedure, AMERICAN INSTITUTE OF ACCOUNTANTS, New York, N. Y., 1956. Pages: 45; fifty cents.

This case study, the eleventh in a series, describes the actual procedures used in an audit of a 150 bed non-profit general hospital. It includes the methods by which the CPAs who conducted the audit obtained necessary information from patients' records while protecting the identity of the patients, used independent specialists to check the value of pharmaceuticals in the inventory, coped with the problem of confirming receivables, the problem of confirming accounts receivable from patients, and dealt in the report with the hospital's policy of not making provisions for depreciation of buildings.

The case study is not offered as the ideal audit program for all hospitals, but as an illustration of the procedures actually used in a typical case.

### Electronics in Business (A Case Study in Planning: Port of New York Authority)

A Research Report prepared for CONTROLLERSHIP FOUNDATION, INC., New York, N. Y., by Herbert F. Klingman; January, 1956. Pages: xviii + 121 (paperbound); \$4.00 (\$3.00 to members of Controllers Institute of America).

This report is the first of a series covering the planning, investigating and preparing for electronic equipment. It reports The Port of New York Authority's experience with this problem. This case study should be a very useful guide to executives of medium-sized businesses who are confronted with the question of whether their operations are large enough to warrant serious investigation of electronic data processing and its potentialities for the business.

### Electronics in Business—Supplement No. 1 (A Descriptive Reference Guide)

Florence A. May, Editor. CONTROLLERSHIP FOUNDATION, INC., New York, N. Y., 1956. Pages: vii + 130 (paperbound); \$3.00 (\$2.00 to members of Controllers Institute of America).

This supplement, covering the six-month period ending December 31, 1955, keeps current the valuable information contained in the basic source book, *Electronics in Business: A Descriptive Reference Guide*.

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(Continued on page 411)

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(Continued from page 410)

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No. 7

## The President's Page

### Committees

One of the most stimulating experiences of a President is in the formation or continuation of the Society's Committees. The hard-working alert Advisory Committee on Appointments reviews the composition of our sixty-seven committees, the Chairmen and the members, giving consideration to over one thousand people. Careful thought is given to the service records of present members and the possibilities and capabilities of new ones. The needs of the committees and the wishes of Society members are recognized and discussed. The President-to-be sits in at some of the day-long sessions and out of these deliberations come suggestions to the President of Committee Chairmen and members.

To produce a balanced, effective committee, the wishes of members cannot always be met nor is it possible to place every one on a committee.

Those who were committee members and failed to attend committee meetings or otherwise showed lack of interest, are often dropped. However, some who have shown keen interest and rendered good service over long years may be rotated to other committees to give new members opportunities to render service.

Those who have served well on committees of somewhat limited scope may be moved to the more important ones. Younger men are thus given the opportunity to serve as replacements.

Admittedly, there is the human element and in the thousand choices some errors will be made. But with the extreme care that is given the errors are few and out of all this finally emerges a splendid group of committees.

One of the privileges of the President was to talk to each of the Chairmen and to find so many instances of cordial support and strong willingness to work for the benefit of the Society. The Committees themselves are now in process of completion of personnel and before the summer holidays begin they will be constituted, probably hold an organizational meeting, and set the direction of their work for the coming year.

To a very large extent Committee action determines the success or failure of a year. In an organization such as ours (or indeed many organizations), accomplishment is only possible by co-ordination of activities of many people.

No organization is effective or worth while without the help of many people dedicated and devoted to it. It is this spirit of cooperation, the heart-warming feeling of working together in common interests, the sense of achievement, the give and take of friendship, the awareness of short and long range goals . . . that keeps our Society moving forward and tingling with life.

ARTHUR B. FOYE,  
*President.*



# Experience and Self-Study in Accounting Education

By HERBERT HEATON, C.P.A.

Formal education can never be anything but the starting point in the total training needed to acquire professional competence, says this author. The elimination of the experience requirement would impose on the public many immature CPAs posing as fully-trained accountants, with consequent harm to both the profession and the public.

We say that ideal preparation for an accounting career consists of a college education—et cetera. The “et cetera” has never been adequately defined and there is a tendency to minimize its importance. This tendency within the accounting profession parallels the general tendency in the United States to credit formal education with capabilities it cannot attain and should not claim.

Education is the process of developing the natural powers of an individual so he may live richly and usefully. It begins in the nursery and continues throughout life. Formal education takes place in schools and is one part of an individual's total education. College education is one part of formal education. The particular significance of college education is its timing. Normally, college students are passing through a transitional stage from supervised and restricted activities to mature acceptance of responsibilities and opportunities.

HERBERT HEATON, C.P.A. (New York and New Jersey), is a member of the staff of Pogson, Peloubet & Co., CPAs.

Mr. Heaton is a member of our Society, a Trustee of the New Jersey Society of CPAs, a member of the Personnel Committee of the American Institute of Accountants, and Chairman of the Auditing Committee of the New York Chapter of the Institute of Internal Auditors.

Most educational opportunities are outside of schools. The aim of formal education is to speed and direct an individual's development so he may take maximum advantage of all educational opportunities. To this end, formal education introduces the student to an organized body of basic knowledge and skills, stressing the development of effective attitudes and methods of thinking. Formal education justifies itself only when it enlarges and gives better direction to an individual's total education or development.

Within the framework of this line of reasoning, we can recognize the case for liberal arts as a part of college education in preparation for accounting careers. Of course, each individual will vary in receptiveness and ability to benefit from liberal arts education. None-the-less, accountants and educators agree in principle that liberal arts are essential. Specific courses, such as English, have been almost universally accepted as a necessary part of the liberal arts curriculum and it is possible to arrive at some rough estimate of a minimum quantity of liberal arts credits to serve as a requirement for admission to the ranks of certified public accountants.

## Availability of Accounting Courses

In the early 1930's, my father served as chairman of the Education Committee of the New Jersey Society of Certified Public Accountants. The files of his committee show that it cooperated with

## *Experience and Self-Study in Accounting Education*

the Economics Department of Rutgers University in establishing the first college accounting course in the State. Today, as chairman of the same committee I find almost 30 colleges in the State offer at least one accounting course and 7 colleges offer accredited accounting majors.

In the early 1930's, technical education in accounting was obtained from experience and self-study and from the pioneering colleges. Today, recognizing the amazing proliferation of college accounting courses and their obvious values, there is a questioning of the need for experience and self-study in developing professional accountants. We say that ideal preparation for an accounting career consists of a college education—et cetera. Should the "et cetera" be dropped?

### **Nature of Accounting Courses**

A study of college accounting courses and textbooks discloses an evolutionary pattern which is not yet complete. For many years, the courses were essentially descriptions of accounting practice. At first the material was organized in chronological sequence starting with business papers and then tracing the bookkeeping procedures from entry in journals and posting in ledgers to the extraction of trial balances and preparation of statements. Organization of material was then changed to give the balance sheet at the beginning of the course before showing how the data was accumulated by the bookkeeping routines. This organization of material was referred to as the "balance sheet approach" and became generally used. A variant was to organize the material around the income statement instead of the balance sheet. Regardless of organization, however, the basic emphasis was on mechanics.

The next phase of evolution was one of increasing emphasis on principles and concepts. Generally the organiza-

tion of material was not changed, but some discussion of concepts was superimposed on the discussion of mechanics. At the present time this phase of the evolution is far from being satisfactorily completed throughout the country. There are, however, a number of individuals and schools leading the way into a third phase of the evolution of courses and textbooks.

The third phase consists of crystalizing accounting objectives and concepts and then organizing courses and textbooks around these objectives and concepts. Two advantages of this approach should be mentioned here: (1) Bookkeeping is not the organizational focus and proper emphasis can be given to the full range of accounting functions (system design, bookkeeping, auditing, statement preparation and statement interpretation); (2) the emphasis is no longer on providing answers but instead is on providing the tools and suggesting the approaches by which sound answers can be achieved in practice. To the extent that these and other advantages can be realized, formal accounting education will have taken a great step forward. Indeed, there can hardly be doubt that the advantages will be realized soon when the tempo of the evolution is considered.

### **Limitations of Accounting Courses**

A medical student observes operations before he joins an operating team. He is a junior member of the team before he becomes assistant surgeon and he works as assistant surgeon before he operates on his own. This sequence of practical experience is necessary no matter how many courses have been taken. When you need an operation, do you want it performed by a successful surgeon or a successful academic student?

Service as a co-pilot is necessary to qualification as a pilot. Service as a

practice teacher is necessary to qualification as a teacher. In hundreds of diverse fields it is recognized that there is no substitute for learning by doing. Some of the reasons this is true will be suggested in the following discussion of the limitations of accounting courses.

Formal education offers an organized body of basic knowledge and skills with the course contents carefully selected and organized. This statement implies one of the basic limitations of college accounting courses. Courses do not teach a student to select and organize for himself. The better the course the better the selection and organization of its contents and the less the opportunity for the student to develop skill in selecting and organizing. A practicing CPA must select pertinent evidence and appropriate procedures. He must be proficient in organizing evidence. Only from experience can he learn the techniques and master the concepts behind the effective selection and organization of evidence which distinguishes every set of good working papers.

Basic knowledge is general, not specific, but the application of general knowledge to specific situations is the essence of accounting practice. Skill in application is developed by experience. In fact, without experience it is almost impossible to understand the need for modification and specific application which arises from the vast variety of business situations. Application requires judgment and judgment is largely predicated on experience. Courses cannot teach judgment; at best they can present some of the elements and approaches on which sound judgment is based.

Solving a problem is usually not as hard as recognizing a problem. Every CPA has helped his clients by recognizing their problems and pointing them out. Once recognized and defined, most problems can be readily solved.

Every senior accountant has caught a junior in failure to recognize some important auditing or accounting problem. Can ability in problem recognition be developed by formal education? Only to a limited extent. And yet the ability to recognize and isolate a problem is one of the basic professional attainments of doctors, lawyers and CPAs. It is a fair guess that most failures to make the grade in professional accounting result from lack of ability in problem recognition. Problem recognition is an ability that must be fostered and tested by practical experience.

College accounting courses are not timely. Advanced courses deal with material a student will not use until he has been in public accounting practice a number of years. One of the major improvements in educational techniques in this century has been making formal education more timely—teaching Johnny to read when he has a desire and need to read. This has been an important accomplishment even though to be ideally effective it would require expensive individual instruction in place of that given in the classroom. Some people have misinterpreted the development, however, and have confused educational technique with educational objectives. The goal of formal education is to impart basic knowledge and skills to enable an individual to take maximum advantage of all the educational opportunities he will encounter throughout life. In the area of specific knowledge and skills, the concept of timeliness clearly indicates the superiority of self-study and experience over formal education.

Formal courses are not up to date. By the time a textbook has been written, printed and distributed it is at least a year or two behind current developments. To catch up, the student

## *Experience and Self-Study in Accounting Education*

must turn from textbooks to current literature. To keep current he must pursue a continuing program of self-study. One of the primary functions of formal education is to give a good start to a self-study program.

### **Can Schools Offer Experience?**

A medical student sees patients and works with them. Can accounting schools bring similar reality to their curricula? Can a whole business like a whole patient be moved into academic halls? There are accounting laboratories where students work with the actual records of defunct organizations, but this is a poor substitute for reality. Accounting lives only as a business control; records of a dead business have no current life or meaning. The effective CPA observes business operations and talks to foremen and other business employees. Can the CPA say that the income statement fairly presents the results of operations unless he knows what the operations are?

Even if an entire business with its employees could be transplanted into a college curriculum, the problem would not be solved. The work of a junior accountant is controlled by close and continuing supervision and review by a senior accountant over an extended period of time. It is this control which gives experience much of its educational value, but individual attention of such magnitude would be quite impractical within most colleges.

### **Auditing Standards**

The CPA certificate is given by a state government as a protection to the public. It is given to an individual after he has achieved a necessary minimum of professional competence. Assume a college graduate with an accounting major but no experience. He enters practice for himself and after his first engagement signs an audit

opinion. This opinion states he has done his work in accordance with the following generally accepted auditing standards:

1. "The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor." Can an individual be considered proficient as an auditor before he has ever worked on an audit?
2. "In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors." An individual can be independent only when he has knowledge of alternatives. This knowledge must be gained by experience.
3. "Due professional care is to be exercised in the performance of the examination and the preparation of the report." Can someone without experience understand the meaning of "due professional care" and have a sense of the proofs and concepts it implies?
4. "The work is to be adequately planned and assistants, if any, are to be properly supervised." Can there be adequate planning without any experience as a guide?
5. "There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted." Internal control questionnaires can be fine crutches, but a little practice with them is indicated before entering the big race.
6. "Sufficient competent evidential matter is to be obtained through

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# The Audit and Control Activities of the Comptroller of the State of New York

By THE HON. ARTHUR LEVITT

This presentation, by the chief fiscal officer of New York State, indicates how the responsibility that devolves upon his office to preaudit the payment of all state monies, prescribe the accounting systems to be used by all state departments, and to audit their books, is discharged.

As you know, the Comptroller is the chief fiscal officer of the State. In New York that makes him the State's chief accountant as well. In discharging this responsibility I must pre-audit the payment of all State monies, prescribe the accounting systems to be used by all State departments, and audit their books. Since I am also charged with the fiscal supervision of the State's municipalities, I must audit the books, prescribe uniform accounting systems, and the form of annual reports for each county, city, town and village in the State, with the exception of our three largest cities and the counties within the City of New York.

The records of the receipts, claims and investments of the New York State Employees' Retirement System and the records of all the investments purchased with money from State funds and funds in the custody of the State are also maintained under my supervision.

THE HONORABLE ARTHUR LEVITT is Comptroller of the State of New York. This address was delivered by him on May 2nd, 1956, before a meeting of the Federal Governmental Accountants' Association of New York, held at the Hotel Commodore, New York City.

Your experience enables you to estimate the accounting problems involved in this vast administrative undertaking. Today I would like to discuss some of them with you.

The Comptroller has been the chief fiscal officer of the State since his office was created in 1797. It wasn't until the 1938 Constitution, however, that the Comptroller was required to audit *in advance* the payment of all State monies.

This power affords much greater control over the disbursement of State funds because it makes certain that every payment conforms with the purpose of the budgetary appropriation, that an appropriation will not be exceeded, that the price paid conforms with quotations, and that all money appropriated for a specific purpose is used only for that purpose.

The State was fortunate that one of its most able Comptrollers, Morris S. Tremaine, held office at the time this change became effective. The basic operations developed under his leadership have not been altered.

## Division of State Audits and Accounts

The Division of State Audits and Accounts of the Comptroller's office audits the payment of all State monies. For efficiency in operation the Division is separated into four sections according

## *The Audit and Control Activities of the Comptroller of the State of New York*

to the purpose and method of the audit performed.

### **Office Audit Section**

The pre-audit functions are conducted by the Office Audit Section which must deal with claims of many different types. The Section is subdivided according to the nature of the audits performed. All purchase orders including materials and supplies, travel, printing and merchandise are handled by the General Audit Unit. The Highway Unit pre-audits all expenditures for the construction, maintenance and repair of State highways and bridges. The pay-rolls of all State employees are handled by the Payroll Unit. There is still another group which maintains a ledger on every claimant receiving unemployment insurance benefits including pre-audits of the claimant's wage records which establish benefit rights and every payment of benefits. Claims for disability payments are handled by a separate Unit but in the same fashion.

Another unit of the Office Audit Section pre-audits all claims for refunds. This is a varied and difficult task. Not only does it include auditing claims for refunds of taxes erroneously paid, for refunds of license fees and the receipts and payments from the Justice Court Fund, but also the funds which the Abandoned Property Law places under the administration of the State Comptroller. This is a particularly delicate task for the interests of the property owners must be protected and, at the same time, the State must be protected against fraudulent claims. By the way, it may interest you to know that the abandoned property monies which eventually revert to the State are required to be placed in the Capital Construction Fund.

The Office Audit Section also contains a land claim unit to pre-audit all claims relating to the purchase of land and

taxes on lands owned by the State, Court of Claims judgments and the United States Deposit Fund mortgages. Since you are Federal government accountants, the mention of the United States Deposit Fund may have interested you. This Fund was established in 1837 with New York State's share of surplus money which the United States deposited with the State. The principal of the Fund, \$4 million, must be kept intact. The income is used for education purposes. The money originally was invested in mortgages which are administered by the Land Claim Unit. All of these mortgages are small. They were placed upon farm land, though some of it, including some mortgaged land in the Bronx, is quite urban now. Some of these mortgages are nearly a hundred years old and all pre-date 1910, when an amendment to the State Finance Law stopped their issuance. Since 1910 the money in this fund has been invested in the same manner as other state funds.

Just this outline of the different types of claims with which the Office Audit Section must deal serves to give you some idea of the complexity of the State's business. Yet this Section deals with only one aspect of the accounting duties of the State Comptroller. There are many others which I would like to mention to you.

### **Accounts Section**

The Accounts Section of the Division of State Audits and Accounts is responsible for maintaining official book-keeping control over the funds of the State Treasury. It accounts for all the revenues received, maintains about 20,000 individual ledgers representing each appropriation in the State budget, maintains control accounts for the entire State financial operation and prepares all warrants and checks.



### **Local Assistance Section**

Another section of this division—the Local Assistance Section—performs functions which parallel some performed by the Federal government, for the State, just like the Federal government, assists in paying the cost of certain local services. The purposes for which the State pays local assistance include education, social welfare, health, housing, conservation, highways, and the cost of operating general government, the last being a form of sharing certain tax revenues with the localities. All these aids are paid according to formulas prescribed by law. Claims in support of their payment must be pre-audited.

### **Field Audit Section**

The fourth section of this Division, the Field Audit Section, supplements the work of the others. There are a great many funds which are outside the State Treasury but under the supervision of the Comptroller and which, therefore, require pre-audit of payments. The largest and best-known of these funds is the State Insurance Fund. In many cases it is not practical to audit these payments in the office, so the special fund unit was organized to perform the audits at the place of disbursement. Other special audits which are performed in the field concern the receipts and disbursements of the many state institutions. Another group of auditors concerns itself with the operating agencies of the State. The concern here not only is with the receipts and disbursements but also with the accounting systems used.

### **Accounting System Work**

As I mentioned at the start, one of my responsibilities is to prescribe the accounting systems used by State departments and agencies. This duty is as

important as the pre-audit of the payment of State funds because it exerts such an influence upon the administrative management of state affairs. A properly designed system of accounts is invaluable in providing the data essential for effective budgeting and vitally needed as an aid to State government in keeping pace with the demands which the people place upon it. A good accounting system provides information about the administration of State programs as well as about the receipt and disbursement of State monies.

In order to provide the most useful information, a great degree of flexibility is required in the accounting systems used by the different departments. Consider the variety of activities in which the State departments are engaged. The Departments of Health and Mental Hygiene operate one of the largest hospital systems in the world. In contrast to this serious business, the Conservation Department manages a great many recreation facilities which contribute so much to the pleasure and health of our citizens: the camping sites at State parks; the concessions at State parks; the Olympic Bobsled Run at Lake Placid, to name only a few.

The Department of Correction operates institutions which are responsible not only for the care of the inmates but also their employment. Diverse accounting systems are necessary to administer their tasks properly.

The knowledge of the accountants who conduct the audits and install the accounting systems in these various state agencies is invaluable. As you know from your own experience, these men develop a great deal of information about the conduct of the business of the agencies with which they work. They develop that extra-sensory perception which some administrators label



as "feel". It assists them not only to make recommendations for improvement but to detect the occasional wrong-doings which the audits disclose. For example, auditors doing institutional work know about what is required to supply an institution. Even though the books balance and the inventory seems correct, when purchases are abnormal or the inventory which the auditor must do shows an unusual condition, further investigation results.

#### **Field Auditing**

Field auditors are required to check all the records of the agency being audited; to count the cash; to reconcile the bank accounts and confirm the balances shown; to verify the entries in the cash receipts journal and make sure that all cash is promptly forwarded to the proper agency. The field auditor checks all the disbursements, and inspects all the equipment which has been charged to the agency. He inspects personnel records relating to attendance, sick leave and overtime. He makes certain that all financial documents including licenses, tickets, stamps and unissued bonds are properly accounted for and taken care of. He determines that all necessary fidelity bonds have been issued for employees. He checks all securities owned and the record of securities outstanding. All this procedure I assume is familiar to you, but I have summarized it to show the detail we go through to see to it that the taxpayer receives full value from the activities in which the State engages on his behalf.

#### **Municipal Financial Accounting**

There is another aspect of the Comptroller's financial responsibilities which may not be so familiar to you—the responsibility for municipal financial accounting. The law requires the Com-

troller to prescribe the system of accounts to be used by municipalities, to prepare comparative financial statistics from the annual reports which the chief fiscal officer of each city, county, town, village, fire and school district must submit, and to audit their financial affairs.

The auditing and reporting processes used are generally familiar to you. The auditor must be certain that receipts and disbursements are properly accounted for and have been received and expended according to law. Every effort is made to have the annual report contain all the information which might be useful to students of municipal governments, to investors in municipal bonds and state and municipal officials.

The accounting systems designed for municipalities, I believe, would interest you. Here again great flexibility is required to meet the various situations which New York State municipalities represent. Recently a new system of accounts for counties was installed. This new system enables the counties to obtain much more detailed and accurate information about their operations than was possible before.

Villages also are converting to a new system of accounts which, we hope, will assist them in their financial affairs. Because of the diversity in the size of villages two different systems—single entry and double entry—have been prepared.

This diversity in size is a major consideration in preparing any accounting system to be used by the municipalities. We wish to prepare systems which will do the most to assist in good municipal government but these systems would fail if they were too detailed or complicated. Many of the smaller municipalities of the State are administered by men and women on a part-time or

spare-time basis. The only reward of their office is the recognition which the office itself gives. They hold other jobs, or conduct other businesses, to support themselves and their families. If we have occasion to telephone one of these people, for example, about an item in his annual report, it is not unusual to be told that he is at work in a neighboring city, is plowing, or, if the official is a woman, we may have called just as she was preparing the noontime dinner. I do not mention these circumstances to be funny, but to show the various conditions under which municipal accounting is conducted. These people are what makes American democratic government so admirable. They are giving of their time and energy for local civic interest. Any accounting system which we prescribe for them must aid them without burdening them or without being so complicated that non-professionals cannot understand it.

### **Experience and Self-Study in Accounting Education**

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inspection, observation, inquiries and confirmation to afford a reasonable basis for an opinion regarding the financial statements under examination." Is there any public accounting firm in practice today which feels its new juniors can determine, without guidance, what constitutes "sufficient evidence" or a "reasonable basis"?

From this brief review, it is apparent that elimination of the experience requirement would sever the connection between the CPA and the standards of auditing. This would be a body blow from which the profession might never recover.

#### **Conclusion**

In almost every trade and profession, experience has been established as a necessary entrance qualification. The

As you can see, the concerns of New York State's chief accountant are many and varied. They include all branches of the State's business and they extend to the municipalities within the State. The men who help me to discharge my responsibilities are a vital force in our government. Because the work is done so well, spending is controlled, fiscal information is available, and the laws regulating State and municipal finance are enforced. As a result, the government of the State of New York and its municipalities are in excellent financial condition today.

Your profession is one of which you can be proud. On local, State and Federal levels, accountants are actively working for more efficient fiscal practices in government. For that job, you and members of your fraternity, deserve the thanks of the people of our country. As Comptroller, I pledge you my continued cooperation in your undertakings.

bar of Great Britain considers experience to be the most important requirement although the examination is also considered essential. The same is true of the accounting profession there and in Canada. In this country, law office study and examination is recognized as qualifying for the bar in over thirty states.

Formal education can never be anything but the starting point in the struggle to acquire professional competence and character. The elimination of the experience requirement would not eliminate its necessity but would, I am afraid, impose on the public many immature CPAs posing as professional accountants. Nothing could possibly be gained, either by the public or the profession, from the elimination of the experience requirement, and much that is valuable would be lost.

# Current Trends in Accounting—XIII

By LEO ROSENBLUM, C.P.A.

Some Capsules Reflecting Modern Practices  
and Current Problems and Conditions

## Practitioners' Problems

### Fees

#### Minimum Fees

It has been proposed to the Committee on Ethics and Unauthorized Practice of the Michigan Association of Certified Public Accountants<sup>1</sup> that a schedule of minimum fees be established for the profession in Michigan.

The Detroit Bar Association, it appears, "has had such schedules for many years and . . . [has] revised them from time to time"; also, the Virginia Society of CPAs "has already established minimum fees."

#### Fee-setting

Derek G. Bee, chartered accountant, writes on "Accountants' Charges" in *The Accountant*.<sup>2</sup>

LEO ROSENBLUM, C.P.A., is Professor of Accountancy at the Bernard M. Baruch School of Business and Public Administration of The City College of New York. He received the degrees of B.S., M.S., and Ph.D., from Columbia University. Dr. Rosenblum is a member of the New York State Society of Certified Public Accountants, the American Accounting Association, and the American Institute of Accountants. He has contributed to accounting and other publications. He is engaged in public practice in New York City.

"Why," he asks, "does not the small practitioner . . . command better fees?"

There appear to be two reasons. The first is ignorance of what represents a fair charge and what other accountants charge for similar work. The small practitioner "works alone, or with others in a similar position, and, if he is fortunate enough to be sufficiently near a district society, branch, or local group, to meet fellow practitioners occasionally, they will talk to him about anything but fees. . . ."

The second reason is fear. The accountant is concerned lest his client leave him "if he tries to increase his charges." Perhaps this is caused by the fact that there have been:

too many quailed accountants during the difficult times between the two world wars, when those who could not find employment took on work at fees so low that they found, when more work became available to them, that they were working all day and half of the night to earn a pittance. These practitioners, greatly daring, may have doubled their charging rates since before the war, but they should possibly have been doubled again, and perhaps again.

Mr. Bee suggests a "recommended minimum scale of daily charging rates which could easily be revised from time to time." He points out that such scale:

could not have an immediate effect on fees and on salaries paid to professional staffs. It would not be possible for a practitioner to increase all his existing fees overnight. It would, however, have its effect on new work undertaken, and, over a period of time, its cumulative effect might be very great. It could certainly have no detrimental effect on anyone.

<sup>1</sup> The Michigan C.P.A., January, 1956, p. 4.

<sup>2</sup> Vol. CXXXIV, No. 4242, April 7, 1956, pp. 374-375.

### Accountants' Insurance

*The Journal of Accountancy*<sup>3</sup> reports the results of a survey by the American Institute of Accountants' state society department concerning accountants' liability insurance programs in the various states.

Thirty-six states replied to the Institute's survey queries. Of these, eleven reported the existence of programs or committees on accountants' liability insurance; in addition, twelve states were considering establishing such programs. The *Journal* notes further that "One of the most comprehensive liability policies has been made available to California CPAs through the efforts of their state society. By the terms of the California policy, the insuring company agrees to pay for damages . . . through:

Negligent act, error, or omission.  
Dishonesty, misrepresentation, or fraud, except if made or committed by the insured with affirmative dishonest or actual intent to deceive or defraud.

Breach of contract, except if committed with affirmative intent by the insured.

"The California policy," *The Journal of Accountancy* continues, "takes into account the problem of the liability of accountants in tax practice matters."

Under the policy, the term *professional services* is defined as "duties performed by and advice given by the insured in the conduct of his business, including, without limitation, duties performed or advice given in relation to matters of taxation, whether or not any claim or suit refers to the insured's professional status as an accountant."

Readers interested in the insurance needs of accountants are referred to the paper by Marion R. Reich and Robert

L. MacReynolds, CPAs, of the California Society, on "Insurance Against the Hazards of Public Accounting," which appeared in a recent issue of *The California Certified Public Accountant*.<sup>4</sup> The authors consider these subjects: unemployment compensation disability insurance; income protection; medical reimbursement insurance; life insurance; accountants' liability insurance.

### Visual Control

In a paper in *The Accountant* called "A Practising Accountant's Visual Control of Statements," E. Edward Boyles, chartered accountant, describes his method for controlling audit engagements.<sup>5</sup>

He uses a wall chart made up of some 1,800 plastic discs or wheels. Each wheel "of which only a segment of the circumference is visible, looks like a little flat coloured signal, about 1/4 in. square." Each disc has

five bright coloured segments around its edge—black, yellow, green, red and white. And as it is extremely easy to nudge the little wheel so that one half of each of any two adjoining coloured segments shows at once, there are really ten colour positions for each little space between the "separators" (the "separators" are long white plastic strips which run horizontally right across the chart doing just that).

Thus what is presented is a "general effect . . . of lines of coloured signals on a white background."

Mr. Boyles describes how he uses the colors to control audits due at the end of the month; audits "completed subject to tidying up"; open matters before the tax department; bills submitted to clients, but unpaid; books not ready for audit in spite of reminders to the client; and for various other purposes.

<sup>3</sup> Vol. 101, No. 4, April, 1956, p. 6.

<sup>4</sup> Vol. XXIII, No. 3, February, 1956, pp. 19-22.

<sup>5</sup> Vol. CXXXIV, No. 4234, February 11, 1956, pp. 147-148.

With this chart before him, says Mr. Boyles, he obtains a panorama of his entire practice:

The effect is so clear and graphic that, standing in front of the chart and regarding it thoughtfully, you have a clear panorama of the whole of the practice before you, with any arrears, bottle-necks, or work avalanches pending, staring you ruthlessly in the face, and seeing the facts is half-way towards planning the sequence of work with due regard to relative urgency.

\* \* \* \*

At first glance, the price of the chart, about £45, may appear rather startling for just a "gadget", but remember the 1,800 little coloured wheels etc.; and there are two accounting considerations. Firstly, how long would it take you to earn another £45 in fees by being able to plan your work with complete and up-to-the-minute knowledge of the position? Secondly, the cost of the chart over a period of (say) twenty-five years on a straight-line basis is less than £2 2s 0d per annum.

#### Reports on Investigations

R. B. Dale-Harris, chartered accountant, and partner in McDonald, Currie & Company, of Canada, is the author of a paper in *The Canadian Chartered Accountant*<sup>6</sup> titled "Reports on Investigations."

His notes "are directed to the young practitioner in the knowledge that the experienced accountant will have already developed his own answer to the problem."

The writer begins his paper by considering the contents, style, and presentation of reports prepared by accountants following the completion of investigations.

Considering the contents of such reports, Mr. Dale-Harris recommends the inclusion of these sub-divisions: Introduction (including a "resume of the terms of reference under which the engagement was accepted"); History and General Nature of the Business (this

would include data dealing with: historical records; products; sources of raw material; markets; labor supply and union agreements; pension plans; and general organization.).

Then, he suggests, the present management of the organization should be discussed, covering these points: competence; employment contracts; ages, retirement dates, and related matters; effect of change of ownership.

At this point, he would consider financial position, operating results, and the prospects for the future. As to the latter matter, he cautions: "The accountant must beware of making irresponsible or unsupported statements as to the future of a business. . . ."

Also to be considered are "the tax effect of the purchase of shares, problems created by designated surplus", and similar matters.

Finally, the accountant "will normally be expected to state an opinion as to the valuation to be placed upon the business." Here Mr. Dale-Harris suggests: "This may be in the form of suggesting upper and lower limits or alternative figures, might be arrived at by suggesting varying methods of computing the purchase price."

#### Management Accounting; Aids to Clients

##### Rehabilitating a Sick Business

This is the title of a paper by Clinton W. Bennett, CPA, of Massachusetts in *The Journal of Accountancy*<sup>7</sup>. "Because of training, experience, and financial discernment," observes Mr. Bennett, "the CPA can be of immense assistance to his clients in alerting them to unsatisfactory trends and, if the evil day comes, to aid them with a rehabilitation program."<sup>8</sup>

<sup>6</sup>Vol. 68, No. 3, March, 1956, pp. 209-212.

<sup>7</sup>Vol. 101, No. 4, April, 1956, pp. 50-53.

<sup>8</sup>Ibid., p. 53.

In the following four areas, notes the author, the accountant may find material which will help him diagnose the ailment from which the business may be suffering: manufacturing facilities; selling and merchandising procedure; management; and economic aspects.

Mr. Bennett describes how the professional accountant should undertake his study of the sick business; discusses, in concise fashion, problems that may arise in the selling and merchandising activities of a company and in management activities.

Three case histories point up the procedures to be followed. They reflect "practical experiences in actual management services practice" and "illustrate the breadth of the areas in which the certified public accountant must expect to become involved if he undertakes this kind of work."

#### Key to Grocery Store Profits

Consider this point in discussing with clients the efficient allocation of sales space in their stores.

A study made by the Psychological Corporation for the Genesee Brewing Company, based on data from more than 300 upstate New York independent grocery stores, yields the conclusion that "the amount of space allotted to each item can hold the key to a store's profits."

Some of the smaller grocers, the Psychological Corporation reports, "are wasting display space on low-profit items and thus are forced to scrimp on display space for the high-profit items."<sup>9</sup>

Beer, bread and soft drinks, it appears, were the biggest profit-makers. Yet the space allocated to these items varied considerably; some stores "were not making the best use of valuable display space."

For example,

In the Rochester area it was found that an average of twenty-seven square feet of floor and shelf space was devoted to beer. Each foot of space provided dealers with a gross profit of \$2.43 [weekly]. On the other hand, twenty-one square feet of floor and shelf space was given over to cereals, although retailers received only about 12 cents a week in profits for each foot of space.

In the opinion of William G. Hildebrand, executive secretary of the New York State Food Merchants Association, the results of the study should "help the independent grocer build profit through a better understanding of how to allocate store space to various commodities in relation to the profits they produce."

#### Restaurants

James E. McNamara, of the hotel accounting firm of Horwath & Horwath, delivered an address recently before the "Short Course in Restaurant Management" of Rutgers University, New Brunswick, New Jersey.<sup>10</sup>

Mr. McNamara discussed "a number of the points of control of food and payroll costs which must have . . . constant attention." He considered purchasing; specifications; receiving; storing; issuing; menu planning; production; menu pricing; sales control; payroll control; payroll classification and analysis; and work performance standards.

Mr. McNamara recommended as "the first step toward maximum payroll efficiency", the establishment of regular procedures for obtaining information about employee performance "in as much detail as is possible and practicable"; "too many [managers] pay no attention to the wealth of information that is already available to them."

<sup>9</sup> Reported in *The New York Times*, April 23, 1956.

<sup>10</sup> *The Horwath Hotel Accountant*, Vol. 36, No. 1, January, 1956, pp. 2-4, presenting some extracts from Mr. McNamara's address.

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He explains how, in the case of a restaurant operating for three meals daily and paying its help on a weekly basis, a "simple payroll control" system might be set out.

Dealing with work performance standards, he cautions that these cannot apply to all restaurants; standards for a combination coffee shop-dining room type of restaurant operation pose problems quite different from those found in a lunch counter operation.

The specialist points out these reasons why payroll costs in restaurants continue to mount:

1. Inadequate direction and supervision
2. Inefficient layouts
3. Insufficient labor-saving devices
4. Overstaffing
5. Improper scheduling
6. Lack of regular, detailed payroll analysis by departments and by positions
7. Insufficient volume, compared with the peak volume which the restaurant facilities are able to handle
8. Pressure of wage increases
9. Premium pay for holidays
10. Failure to forecast business and improvise during days and months of slow business
11. Shorter work week
12. Inadequate menu prices.

#### Checks Signed in Facsimile

The Controllershship Information Service, offered in *The Controller*,<sup>11</sup> reports that queries received recently by the Controllershship Foundation concerning facsimile signature checks "have centered around three major points," namely, legal responsibility in the event of alteration; insurance company attitude; and company control practices.

The Foundation summarizes "a consolidation of opinions and experiences regarding these points"; the basis is statements by banks and insurance companies as well as reports from companies using such facsimile check-signing procedures.

On the subject of legal responsibilities it is reported:

Courts have ruled that banks accepting spurious signatures are liable, whether these signatures are handwritten, mechanical, or printed. Some banks, in an effort to limit their liability, attempt to get customers using facsimile signatures to sign contracts or make private agreements relieving the bank of responsibility. Even with such a contract or agreement, however, some attorneys believe that the depositor might be able to hold the bank liable if negligence could be proved in the bank's scrutiny and acceptance of signatures.

Insurance company attitudes are as follows:

Some insurance companies and their association representatives indicate that they prefer writing forgery insurance for companies who use mechanical check signers, having found loss due to counterfeit mechanically affixed signatures practically negligible.

Finally, on the subject of control practices, companies using facsimile signatures have employed the following practices to obtain control over the checks:

1. Physical control of the machine, key, and signature plate. (Machine is opened by two keys—one used by an executive and the other by the operator.)
2. Comparison of machine dial readings with check payment authorization sheet.
3. Internal and/or public audit of the comparative readings and/or location of key and plates.
4. Limitations on amount drawn for any one check.
5. Limitation on type of check (or account) to be signed by facsimile signature.
6. Forgery insurance on bonded personnel.

#### Cost Cutting

Illustrative of the savings to be effected through the use of computer-development programs, D. A. Woelner, Chief of Systems and Procedures of Con-

<sup>11</sup> Vol. XXIV, No. 2, February, 1956, p. 93.



vair (Division of General Dynamics Corporation), offers this comparison designated "A Typical Indirect Operation"<sup>12</sup>:

**A Typical Indirect Operation:**

By Hand—One month  
By Desk Calculator—One day  
By Punch Cards—One hour  
By Relay Computer—One minute  
By Electronic Computer—One second.

**Ethics**

**Competitive Bidding: Florida**

All the CPA firms and individual practitioners in the city of Tallahassee, Florida, addressed a signed letter to the City Commission informing it that they would not submit competitive bids for annual engagements involving the auditing of the records of the municipality and the city-owned Tallahassee Memorial Hospital.<sup>13</sup>

A similar letter was sent to the trustees of the Hospital. The accountants "explained the reasons for refraining from bidding and quoted an opinion of the group . . . approximating what the fee should be for the two separate audits."

The City Commission, it is reported, took no exception to the CPAs' position. However, "one member of the Board of Trustees of the hospital is reported to have expressed the opinion that bids should be sought from CPAs in other cities."

**Privileged Communications**

The *Pennsylvania CPA Spokesman*<sup>14</sup> reports that the U.S. Court of Appeals for the Seventh Circuit reaffirmed the right of an Illinois Certified Public

Accountant to refuse to testify concerning information obtained in his confidential capacity as a practicing Certified Public Accountant.

This abstract is from the decision of the Court:

The State Legislature has declared it to be public policy in Illinois that public accountants shall not be required to testify about information obtained in their confidential capacity as accountants.

This policy would be defeated if any court, state or federal, sitting in Illinois, should require an accountant to testify as to such information. This would be true whether the testimony was to be used in a court sitting in Illinois or in any other state.

**C.P.A. Examinations**

**Tightening the Requirements**

Under the caption, "CPA Examination Requirements Tightened", *The C.P.A. Newsletter* (of the California Society of Certified Public Accountants)<sup>15</sup> reports that The California State Board of Accountancy has amended its rules, putting into effect these more severe regulations:

1. A candidate who passes two or more subjects or the single subject of Practice shall be allowed a conditional credit provided he obtains an average numerical grade of 50 for the subject or subjects failed, with Practice being given a weight of 2; and provided further that the remaining subject or subjects are successfully completed within five years.
2. A candidate who does not obtain the average numerical grade of 50 will not be permitted to sit again for the examination until he has completed an additional nine semester units, or their equivalent, in accounting, auditing, or commercial law.

**Personal Interviews**

It is the practice of the Idaho State Board of Accountancy to conduct per-

<sup>12</sup> "A Computer Development Program," in *Journal of Machine Accounting Systems and Management*, Vol. 7, No. 2, February, 1956, p. 4.

<sup>13</sup> *Florida Certified Public Accountant News Notes*, Vol. IV, No. 16, February, 1956, p. 3.

<sup>14</sup> Vol. XXVI, No. 5, March, 1956, p. 3.

<sup>15</sup> Vol. 9, No. 7, March, 1956, p. 2, reporting the action of The California State Board of Accountancy on January 19-20, 1956.

sional interviews with applicants for the CPA Examination before the candidates take the examination.<sup>16</sup> The purposes are to clarify "any questions pertaining to the additional section on Professional Ethics . . . and to give the Board members an opportunity to meet the applicants personally."

The Board also holds a "general discussion" with each candidate "covering . . . prior performance in the examination . . . , method of preparation, and the accounting profession in general . . . ."

The Board intends to continue this practice, interviewing all new applicants for admission to the examination.

### Accounting Theory

#### Replenish This Wasting Asset

In an editorial called "Accounting Research in New Zealand," in *The Accountants' Journal* (New Zealand),<sup>17</sup> it is pointed out that since research is the life-blood of accountancy, "the existing store of knowledge must be replenished from time to time in the manner of any other wasting asset."

The editorial represents an appeal for participation by New Zealanders in accounting research work; points out that "Bacon's dictum that each man is a debtor to his profession is observed with much generosity by accountancy organizations abroad—the traffic should not be one way." It closes with this advice:

"Much research has been and will continue to be inspired by enthusiastic individuals, but there can be no substitute for the pooling of knowledge, ideas, and experience which team work provides."

#### Some Questions

"Should Accounting Theory Be Revised?" asks Bernard Whitney, CPA, of Los Angeles, in a paper on "The Accountant's Role in Operations Research."<sup>18</sup>

He queries, further, whether "present methods of preparing accounting reports properly reflect costs, efficiency of operation, or the skill of management," and whether it is correct to show on the balance sheet, as completely written off, assets with a large residual value.

Further questions raised by him are these: "Should interest on capital investment not be included as a cost factor?" and "Should the salaries of owners and partners not be a part of the normal operating expenses?"

"Unless these factors are corrected and made uniform," this practitioner states, "management has no way of measuring the success of its enterprise against that of others." A further difficulty is that of "comparing present operations with those of the past."

### Taxes

#### Automobile Expense Disallowed

Under *Revenue Ruling* 56-25<sup>19</sup> automobile expenses incurred by an employee in commuting between his home and his place of work, even though the automobile is used to transport the tools which he uses in such work, represent nondeductible personal expenses within the meaning of Section 262 of the Internal Revenue Code of 1954. This is true regardless of the distance involved.

The Ruling holds that "The expenses so incurred in going to and from work were not increased by reason of the

<sup>16</sup> *The Idaho CPA* (Membership Bulletin of the Idaho Society of CPA's), Vol. 6, No. 5, March 6, 1956, p. 1.

<sup>17</sup> Vol. 34, No. 6, January 2, 1956, p. 209.

<sup>18</sup> *The California Certified Public Accountant*, Vol. XXIII, No. 3, February, 1956, pp. 13-18.

<sup>19</sup> *I.R.B.* 1956-5, 9 (January 30, 1956).

fact that the tools used by the employee in his work were also transported in the automobile," and that "Thus, the entire amount of the expense is deemed to be commuting expense, no part thereof being allocable to the transporting of the tools."

#### Parking Lot Charge Not Subject to the Admissions Tax

Under *Revenue Ruling 56-38*,<sup>20</sup> a parking lot charge applied as a credit to an admission charge is not subject to the admissions tax; such parking charge is not an amount paid for admission as contemplated under Section 4231 of the Internal Revenue Code of 1954.

It appears that in an effort to induce patrons to attend evening shows a number of downtown motion picture theatres in a large city arranged with parking lot operators for a special evening parking rate of 25 cents a car for the movie patrons.

Upon paying the parking charge the patron was given a receipt. On presenting this to the cashier of the movie house he was entitled to a credit for the amount paid for parking, against the charge for admission to the theatre.

Special tickets of admission were issued to these patrons, only one such admission being granted for each car parked. The higher charge has to be paid by or for the other persons, even those who were passengers in the same automobile.

Thus, for example, if the established price for the accommodations were 80 cents plus admissions taxes, a patron who presented the receipt for 25 cents from the parking lot operator could obtain a special ticket for 55 cents plus the admissions tax. His privileges

and accommodations were the same as those of one who had paid 80 cents plus the tax. No part of the parking charge was received by the theatre operators.

#### Advice to Legislators

This paragraph, captioned "Avoidance and Evasion," appears in the "Law Commentary" section of *The Accountants Journal* (England):<sup>21</sup>

Complex and obscure provisions in Finance Acts stimulate the ingenuity of those who may be minded to avoid taxation legitimately, whilst offering strong temptation to those willing to evade their obligations, and thus they tend to defeat the main purpose of legislation, which is to set forth rules of law succinctly and in a readily digestible form. But to achieve that purpose is far from easy in an increasingly complex society and economy.

#### General

##### Challenge

John H. Zebley, Jr., President of the American Institute of Accountants, presented a paper entitled "Challenges to the Accounting Profession" before the Michigan Accounting Conference, at Ann Arbor, last fall.<sup>22</sup>

The challenges our profession faces, he states, fall into two classes:

1. Those arising within the profession.
2. Those initiated outside the profession.

The problems which arise outside the profession fall, in turn, into two divisions: first, those attributable to technological changes in ways of recording business transactions or carrying them out; and, second, challenges "forced on the profession through the activities of some who would take over for themselves certain segments of the practice of public accounting as it has been

<sup>20</sup> I.R.B. 1956-6, 14 (February 6, 1956).

<sup>21</sup> Vol. XLVIII, No. 577, March, 1956, p. 76.

<sup>22</sup> *The Accounting Review*, Vol. XXXI, No. 2, April, 1956, pp. 173-181.

carried on for many, many years."<sup>23</sup> In the latter group, "most prominent . . . is the difference of opinion over the place of the CPA in tax practice."

Turning to the challenges which have arisen within the profession itself, Mr. Zebley discusses these points: the attraction of personnel; the uniform CPA examination; standards of education and experience for CPAs; specialization in practice; accounting instruction; the formulation of accounting principles and standards of reporting.

Discussing the formulation of accounting principles and standards of reporting, the eminent practitioner comments:

Care must be continually exercised that pressures exerted through changing methods of taxation or caused by the exigencies of business have no untoward effect on the determination of accounting concepts and principles generally applicable for financial reporting purposes.

Research into and periodic testing of the usefulness of current accounting principles are necessary to their continued acceptance by the profession as a whole. The lead in this respect must be maintained by the profession, otherwise accounting principles and standards may be developed by government edict or, what would be worse, by unfortunate litigation.<sup>24</sup>

He concludes with the hope that "some individuals who have not heretofore given diligent thought and attention to those problems may be aroused to take a more active part in their solution. . . ."

#### Advice to Prospective Servicemen

Paul S. Kramer, a private in the Army Audit Agency, and a staff member of Arthur Young & Company before entering the service, has written a paper offering "Some Words of Advice to Prospective Draftees."<sup>25</sup>

The soldier points out that wherever a serviceman is sent while in the Army, he is likely to find ample spare time. Young accountants, he suggests, might spend this time well in planning to improve themselves in the field of accounting.

Mr. Kramer suggests a program: the Army libraries offer diversified collections of technical books and can generally secure almost any accounting book not in their collections which a soldier might seek. In addition to a "self-initiated-program of reading," some men in the army "may be able to take specialized or advanced accounting or technical courses offered at colleges or universities" near their bases.

At the very least, he recommends, young accountants should "keep in touch with current trends and thought in accounting by reading the periodic technical literature."

#### Translation

"Professional Ethics" by John L. Carey, Executive Director of the American Institute of Accountants, has been translated into German by Professor Hans Krasensky of Vienna, under the title "Das Berufsethos des Amerikanischen Wirtschaftsprüfers (CPA)."<sup>26</sup>

Following a preface and introduction, the translation of Mr. Carey's book is presented page for page (a page of English being followed by the corresponding page in German) throughout the pamphlet.

A further valuable contribution is the glossary of accounting and financial terms in English with the corresponding German equivalents, which runs eight double-column pages.

(Continued on page 435)

<sup>23</sup> *Ibid.*, p. 175.

<sup>24</sup> *Idem.*

<sup>25</sup> *The Arthur Young Journal*, Vol. 3, No. 3, January, 1956, pp. 38-42.

<sup>26</sup> Vienna, 1953, Manzsche Verlags- und Universitätsbuchhandlung, pp. 52.

# Was Shakespeare an Accountant?

By DEREK LUKIN JOHNSTON, C.A.

Some have thought that the immortal bard was Francis Bacon, a lawyer, but internal evidence strongly suggests that he was an accountant.

I am well aware that in claiming Shakespeare as a principal forerunner of the modern chartered accountant, I am taking arms against a sea of troubles. The theories about Shakespeare's life and the authorship of his works are almost innumerable, and each one has its own guard of vigilantes ready to pounce upon a newcomer. However, the poet himself has written:

We must not stint  
Our necessary actions, in the fear  
To cope malicious censurers

and so I shall proceed to my thesis that William Shakespeare trained and practiced as a professional accountant before, and perhaps even while, he wrote his plays and sonnets.

First, let us look at the circumstantial evidence afforded by his works. The most casual reading of these shows them to abound with references to audits, accounts, and taxation. Hamlet, tormented by thoughts of his father murdered in

his sleep with no chance to confess and be shriven of his sins, cries out,

And how his audit stands who knows save heaven?

At the outset of the same play we find some words which surely are a cry from the heart of an accountant in the throes of the busy season:

What might be toward, that this sweaty haste  
Doth make the night joint-labourer with the day?

In *Othello* we find the Duke addressing Desdemona's father in the very terms with which a modern auditor might instruct his articulated student:

To vouch this, is no proof  
Without more wider and more overt test.

Later, *Othello* cries to Iago,

Give me the ocular proof

—a sound principle of auditing which has stood the test of time for 350 years.

In *Much Ado About Nothing* Leonato says in the first act,

You tax signior Benedick too much

—an obvious literary sequel to the author's appearance, on behalf of a client, before an Elizabethan income tax appeal board!

In the first part of *King Henry IV*, a thief speaks of his prospective victim as

a kind of auditor  
One that hath abundance of charge too,  
God knows what.

DEREK LUKIN JOHNSTON, C.A., originally presented this paper as a radio talk over the C.B.C., on September 12, 1954. Thereafter, it was published in the November, 1954 issue of *The Canadian Chartered Accountant*, from which it is here reprinted by permission.

(I hasten to point out that there is no implication here of the auditor charging excessive fees; in the context the word "charge" relates merely to the moneys which he is known to be carrying.)

Inflation was a problem in Shakespeare's day as it is in ours, and when Falstaff remarks in Act IV of *The Merry Wives of Windsor* that he had been

Set in the stocks, in the common stocks

surely it is naive indeed to find only a reference to punishment, and not see deeper into the sound financial advice that Shakespeare the accountant was giving to his audience.

Then in *King Henry V* that rascal Pistol, planning to be a war profiteer, uses phraseology that could only have been placed in his mouth by a professional accountant:

For I shall sutler be  
Unto the camp, and profits will accrue

I think I have quoted enough, from many examples, to show that Shakespeare was thoroughly familiar with the best professional auditing and accounting standards of his day. Some victims of my theory have expressed surprise that the practice of auditing was common in Shakespeare's time. The art of auditing goes back at least to Roman times. The word "audit" derives from the Latin verb *audire*—to hear; for it was the custom for the auditors to "hear" the "accounts" of transactions which stewards, or agents, gave verbally. In medieval times the great English universities used to brew a specially strong ale on the occasion of "audit days", and this was known as "audit

ale". I commend the revival of this pleasant custom to modern business.

Where did Shakespeare obtain his detailed knowledge of professional auditing and accountancy? Let us first consider the three major questions which form the kernel of the so-called Shakespearean mystery:

1. How did the son of a poor yeoman in Stratford acquire the extraordinary range of classical, historical, and general knowledge which is demonstrated in the plays?
2. Between 1585 and 1592, we have not a single documented fact about William Shakespeare. Where was he during all that time?
3. The location of at least ten of his plays is Italy, and in these Shakespeare displays a remarkable knowledge of Italian geography and language, knowledge virtually impossible for him to acquire without having visited Italy. Why did he go to Italy, and where did he stay when he was there?

Among the existing theories, I cannot find one that fits the problem so easily and adequately as that which I am going to propound:

Shakespeare went to Italy to study the new art of double-entry bookkeeping and, in all probability, articulated himself for the usual term of five years to one of the distinguished Italian accountants who were at that time far and away ahead of their professional colleagues in other countries. Double-entry bookkeeping, the means of recording financial transactions employed by 99% of the business world today, was invented in the wealthy trading

### *Was Shakespeare an Accountant?*

cities of Renaissance Italy. The first known work on the subject was published by Fra Luca Paciolo in Venice in 1494, and he was followed by other accountants in the 16th century: Manzoni in Venice, Pietra in Mantua, and Grisogono of Dalmatia (the Illyria of *Twelfth Night*). All these places are frequently mentioned in Shakespeare's Italian plays.

Now the biographers and researchers have been assiduous in their efforts to find traces of Shakespeare in Italy. They have pored over the records of the Renaissance houses of learning, they have ransacked the university registers, even to finding two students named Rosencrantz and Guildenstern on the rolls of Milan University in the 1590's. But . . . not a clue about Shakespeare. The reason? The professors have been barking up the wrong tree. Let them search counting house records, registers of apprentices to the bankers' or the goldsmiths' guilds, and see what they find. I suggest that Shakespeare was apprenticed for five years to a professional accountant in Venice, Mantua, or Padua, and finally returned to England as a qualified accountant, settling down to practise with all the prestige of a specialized training acquired abroad. As additional evidence, I cite Shakespeare's use of the technical accounting phrase "Debitor and creditor"—to be found in *Othello*, Act I and *Cymbeline*, Act V—which I believe to be the first recorded mention of double-entry bookkeeping in England.

What made him give up a profitable accounting practice and turn to the romantic but less secure field of drama and poetry? Perhaps he tried writing and acting as a hobby, and when he had

achieved some success he did not feel he could return to the sober world of ledgers and vouchers. Perhaps the change was gradual and for a time he continued his accounting work by day, and went on the boards by night. His growing interest in the theatre at this time is well expressed in the words uttered by Puck in Act III of *The Midsummer Night's Dream*,

I'll be an auditor;  
an actor too, if I see cause.

It has been held that since the plays are full of allusions to lawyers, mortgages, leases, etc., Shakespeare was once a practising attorney. Nonsense. My good friends in the legal profession tell me that although there is much good law in the plays there is also a deal of bad law. It is my own impression that where Shakespeare is dealing with business, contracts, bonds, etc. he is accurate, and this of course one would expect from his accountant's training in basic commercial law. But when he gets into criminal law I think he bogs down hopelessly.

The trial scene in *The Merchant of Venice* provides a splendid dramatic vehicle for Portia's "quality of mercy" speech, but as an example of a civil case where one party is on the point of being allowed to commit murder under the noses of the judge and jury, I cannot think it would stand the scrutiny of the Council of the Law Society for five seconds.

Besides, what lawyer with any conception of loyalty to his profession could let creep into his published work the phrase, "the law's delays" uttered by Hamlet in his most famous soliloquy? Or the proposal by one of Jack Cade's



## Was Shakespeare an Accountant?

rebels in the second part of *King Henry VI*, Act IV, that

The first thing we do, let's kill all the lawyers

It is true that a few moments later in the same play, Jack Cade and his followers hang the clerk of Chatham, who appears to have been an accountant of sorts. However, the clerk allowed his name to be mentioned publicly as a specialist in reading and writing, and I think Shakespeare permitted his execu-

tion simply as a dreadful warning against self-advertisement and similar breaches of the code of professional ethics.

My case for Shakespeare the accountant rests, and I submit it confidently to the audience in the words of Flavius, the steward, to his master Timon of Athens, in Act II,

If you suspect my husbandry of falsehood,  
Call me before the exactest auditors  
And set me on the proof.



## Current Trends in Accounting—XIII

(Continued from page 431)

### Economics

A British practitioner suggests, in a letter in the Editor of *The Accountant*,<sup>27</sup> that incentive for buying government bonds might be created if the yield "were pegged to a cost-of-living index

in a manner similar to that in which wages are pegged . . ."

The correspondent opines that "Faith in saving is being destroyed" when "so-called saving has produced heavy loss of purchasing power" for the would-be savers.

<sup>27</sup> Vol. CXXXIV, No. 4238, March 10, 1956, pp. 277-278.



# Valuation of an Accountant's Practice

By WILLIAM L. BETZ, C.P.A.

This paper discusses the major factors involved in evaluating an accounting practice about to be transferred.

The valuation of an accountant's practice depends on many variables. To define the word "valuation" more specifically, we mean the amount of money which should be paid to a practitioner who transfers his clientele and good will to another accountant, who intends to continue the practice. A valuation may also be placed on a partnership interest.

When considering valuation, it is obvious that the valuation may be different from the respective viewpoints of the prospective transferor and transferee. The transferor may wish to transfer his practice because of a desire to enter another field, such as business, or government service; or because he has been advised by his doctor to take it easier; or because of a desire to relocate in another climate, for the benefit of his own health or that of a member of his family; or the practice may be offered by the estate of a deceased accountant. Perhaps, also, the practice is becoming too large for the transferring

practitioner, and he wishes to sell a partnership interest or part of the clientele to another accountant.

The transferee may be presently employed, but desirous of acquiring a practice in order to engage in the profession on a full-time basis; or he may be anxious to increase his income, if he presently has a small gross and time available, whether his own or that of his staff. In each set of circumstances it is obvious, that the reason for the transfer has a bearing on the consideration.

## Valuation of Good Will

### *Businesses:*

Many accountants at some time have been asked to put a valuation on the good will of a client's business. Each business has its own formula. Taxpayer's valuation of good will, based on the formula in Appeals & Review Memorandum 34, was accepted in the *George J. Staab* case (20 TC 834). The Tax Court decision said in part:

"Good will may be defined by the following formula: Good will equals  $a$  minus  $b$ , where  $a$  is capitalized earning power and  $b$  is the value of assets used in the business. Good will, then, is an intangible, consisting of the excess earning power of a business. A normal earning power is expected of the business assets, and if the business has greater earnings, then the business may be said to have good will."

### *Other Professions:*

Other professions have their methods of valuation in the event of the transfer of a clientele. Usually in the legal profession it is based on the value of the furniture and the library, plus good will.

In the dental and medical profession there is equipment involved, plus an

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This paper was presented by Mr. Betz at a technical meeting of the Society, sponsored by the Committee on Problems of the Individual Practitioner, held on November 17, 1955, at the Engineering Auditorium in New York City.

## Valuation of an Accountant's Practice

amount for the good will. Not long ago a medical professional magazine published an article regarding the sale of medical practices. Without detailing the gross income it recited sales prices, ranging from \$1,500 for the practice of an internist, who found himself in the wrong neighborhood, to \$25,000 for one custom-built medical office, of a doctor who had practices in each of two booming towns. The same article details the methods followed in the sale of a practice grossing \$32,000. That particular transaction included tangible assets worth \$5,000 and the consideration was \$12,000, payable \$3,000 in cash, and the balance at the rate of \$300 a month over  $2\frac{1}{2}$  years, beginning three months after the transfer. It appears that in the medical field the demand for practices is not as great as the number of practices offered.

### Accounting Profession:

In the accounting profession a minimum of tangible assets is involved in the transfer. These can be disposed of as a separate item in the contract. The seller can ascertain their value by having an appraisal made.

As to the method of valuing the good will of an accountant's practice, it seems to the writer that it would be a good idea to follow the technique often employed by expert appraisers. For instance, to help arrive at an appraisal, a real estate specialist searches the records for transactions involving similar properties, in comparable locations, at recent dates.

Research undertaken in an attempt to apply the same methodology to accountants' practices actually transferred or offered for transfer, disclosed 25 actual transactions, 20 offers to buy, 19 offers to sell, and 19 additional methods of arriving at a formula. This information was gathered from personal interviews;

advertisers in the *Journal of Accountancy*, *The New York Times*, and the *New York Certified Public Accountant*; articles in the *Journal of Accountancy*; etc.

While no definite chart of the prices paid can be constructed in order to arrive at a trend, there is specific evidence that the tendency is upward. Individual considerations vary from 45 to 200% of the gross fees. Thirteen transactions where the total consideration involved has been ascertained average 103% of the gross. Two recent transfers are known to have taken place at 150 and 200% of the gross, respectively. On the other hand, we recently heard of a transfer of a Pennsylvania practice for  $37\frac{1}{2}\%$  of the gross, payable  $12\frac{1}{2}\%$  per year for 7 years.

Many of the formulas advanced have mentioned valuations based on net income, either before or after fair remuneration for the principal or partner. However, in all actual transfers studied, the consideration has always been based on the gross fees. Probably this is because the gross fees of the practice transferred are readily ascertainable for past years, while expenses deducted to arrive at the net income can be controlled by the acquiring practitioner.

If the amount to be paid for the good will is based on gross fees of future years, a definite understanding should be arrived at as to the meaning of gross fees. The transferor can, of course, show his figures for the past year or number of years, and these will be of interest to the transferee. But an accountant taking over a practice would not want to pay for accounts he would not retain, or clients in a highly specialized field, or perhaps work which would involve traveling.

When we speak of a figure of gross fees on which payments are to be made,

## Valuation of an Accountant's Practice

we should limit ourselves to the fees received from the clients transferred during a specified number of years, during which the practice is handled by the *new* accountant. Any additional work performed by the transferee for such clients should not be included in the basis for payments, nor any increases in fees for the work formerly done, nor any fees from new clients recommended, or fees from subsidiary or allied interests not handled by the transferor prior to the transfer. This definition of gross fees was summarized in the Practitioners Forum of the *Journal of Accountancy* in the May, 1955 issue.

A formula was suggested in the event of taking over the practice of a deceased accountant, namely, the payment by the acquiring practitioner of 50% of the first year's fees *received* from the transferred clients and 25% of the second and third years' fees; however, the percentages are to apply *only up to and not beyond* the billed value of work done by the deceased practitioner during the 12 months immediately preceding the transfer of the practice. In that way the acquiring practitioner is not penalized for additional work that develops. This formula is given here not as an endorsement of the percentages to be paid, but as a guide to the limitations to be placed on the amount of money to be paid.

### Other Factors Involved

When acquiring a practice consideration should be given to three things: first, the increase if any in the operating expenses of the acquiring practitioner,—rent, salaries, supplies, traveling, etc.; second, the progressively higher increase in federal and state income taxes on the additional taxable income; and third, the size of the payments which must be made to the transferor of the practice.

1. The largest item of increased expense will obviously be salaries. To the sole practitioner, who has the time to do all of the work involved in the added practice without neglecting his present work, there will of course be no increase in payroll. But it may be necessary to hire one or two assistants, or a man on a per diem basis, depending on the volume of work. On the other hand if the transferring practitioner has a staff, these employees might continue in the employ of the successor.

2. As to the increase in income taxes resulting from the increase in the new accountant's taxable income, three methods of handling the payments to the transferring accountant have been mentioned in the sources consulted:

First, the transferring accountant may agree to assist in a consulting capacity when requested. In this event, the stipulated compensation paid him as such is taxable to him as ordinary income, and is deductible by his successor from his taxable income.

Second, based on the *Horton* case, (13 TC 143; 180 Fed. (2d) 354) the parties may assign a certain percentage of the consideration to good will, taxable to the transferor as capital gain, and the balance of the consideration may be assigned to the covenant not to compete, taxable as ordinary income.

Third, based on the *Wyler* case (14 TC 142) the entire payment may be assigned to the transfer of good will, taxed to the transferor as capital gain. This will not permit the acquiring practitioner to take any deduction from his taxable income for the amount so paid. Incidentally, it may also be possible to take advantage of the installment method of reporting capital gains.

3. Of the fourteen transfers which it was possible for the writer to analyze,

## Valuation of an Accountant's Practice

the annual payments varied from 15% to 100% of the purchase price of the practice, the greater number being 20% thereof.

From the purchaser's viewpoint, it is generally desirable to make the annual payments as small as possible, spreading them over as long a pay-out period as can be arranged.

So far, we have referred only to the actual transfers revealed by the committee's research. We will now consider the offers to buy or sell and the formulas suggested.

### Offers to Buy

The offers to buy did not give full details, but two offered 100% of gross fees, while four offered 150% of the gross. Terms of payment were two to five years. The offers of 150% were made in 1954 and 1955.

### Offers to Sell

The offers to sell were analyzed by a Virginia practitioner from advertisements in the *Journal of Accountancy* in 1948 to 1951. Eighteen practices were offered for an average of 83%: Three for 50 to 60%, seven for 70 to 80%, two for 81 to 90%, five for 100 to 110%, and one for 125% of the gross. These were located in 14 areas of the United States. These offers, it will be noted, are not of recent date. In the present sellers' market, sellers probably do not have to advertise. Doubtless at

the present time much higher prices would be asked.

The various formulas were suggested in the *Journal of Accountancy* and other sources, and include an actual formula for valuation of a partner's interest. In these cases, as well as in the offers to buy or sell, they are not actual transactions. Various bases suggested were gross fees, gross profits, net profits, and net profits after fair compensation for the partners.

Of course these formulas are valuable in determining what you should pay, and lead to an indication of the net income available, after payment of taxes and payments to the transferee.

### Summary

In concluding, the major factors to bear in mind on the transfer of an accounting practice are:

The gross fees.

The additional expense necessary to handle the added clientele.

How it will fit in with your present schedule.

Whether there are any clients whose work you cannot handle, or do not wish to handle.

How much your federal and state income taxes will increase.

How much and how long you will have to pay for the good will.

How much net income will be left after taxes and payments.



# Orrin Reynolds Judd

By THE COMMITTEE ON HISTORY

Orrin Reynolds Judd, a Certified Public Accountant for over fifty years, was born in Kingston, New Jersey, on November 4, 1870, the son of the Reverend Orrin Bishop and Susanna Reynolds Judd. Most of his working life was spent in banking, but he was active as an independent accountant in two different stages and was always interested in the affairs of accountants, and participated in the work of the accounting societies.

Mr. Judd's first job was with the People's Bank on Canal Street, in 1885. He received \$3 a week for working on their books of account and was increased to \$4 a week within a year. He continued his education at night while working for People's Bank and its successors, and received his certificate as a Certified Public Accountant in 1902.

Election Day in 1891 fell on November 3rd and gave rise to an interesting incident. Mr. Judd was eager to cast his first vote, but his right to register was challenged by the election officials. The Corporation Counsel of Brooklyn ruled that, since the law disregards fractions of days, he became twenty-one on the last day of his twenty-first year, and should be permitted to vote.

He was graduated from New York University School of Commerce, Ac-

counts and Finance in 1902, as a member of its first class. Continuing at N. Y. U., he was awarded the degree of LL.B. from the Law School in 1904 and was admitted to the New York Bar. He decided to stick to banking and use his legal knowledge in trust work. He taught evening courses at the N. Y. U. School of Commerce until 1909, as well as serving as a teacher for the American Institute of Banking.

When he received his C.P.A. certificate, he was employed in the personal trust department of Knickerbocker Trust Company. A year later, in lieu of a salary increase, he was given permission to do outside accounting work, beginning with one of the estates the Trust Company was handling. He founded Nassau Audit Company and served a variety of mercantile clients until 1910, when it became necessary to devote full time to the trust work of Columbia Trust Company, which had merged with Knickerbocker after the 1907 panic. The accounting practice was taken over by Cornwall and Firth, who had been associates in the Nassau Audit Company.

Columbia Trust Company in turn became involved in a series of mergers. In 1923, it became Irving Bank-Columbia Trust Company, and Mr. Judd was made a Vice-President. He was later made head of the personal trust department of Irving Trust Company. In 1933, he was honored with election as Vice-President of the Corporate Fiduciaries Association of New York, and the same year retired from Irving.

There followed two years of independent accounting from his own office. In

This is the nineteenth in a series of articles on the History of Accounting in the State of New York. It was prepared by the Society's Committee on History.

### *Orrin Reynolds Judd*

keeping with the depression economy, he specialized in mortgage reorganizations, and was appointed a temporary Trustee of Series F-1 of New York Title & Mortgage Company by Justice Alfred Frankenthaler.

In 1935, he was invited by Jacob C. Klinck, President of Kings County Savings Bank, to help out for a year while Mr. Klinck was Grand Master of Masons of the State of New York. Beginning a new banking career as Cashier, Mr. Judd stayed on through the terms of three succeeding presidents, becoming a Vice-President, a Trustee, and then Executive Vice-President, the position he held at the time of his second retirement in 1953.

Mr. Judd belonged to The New York State Society of Certified Public Accountants and had been a chairman of its History Committee. He was a member of the American Institute of Accountants. He also belonged to The Accountants' Club, of which he was an honorary member, and the Downtown Association, the Society of Colonial Wars, and the New England Society of New York.

New York University continued to occupy a large place in his life. He was active in its alumni affairs and in 1934 was given the Alumni Award for Meritorious Service. He had been elected to the Council of the University in 1931, and served as its Secretary from 1938 to 1951. He retired as a member of the Council in 1953, but continued as an

Associate until his death on March 5, 1954, at the age of 84.

Mr. Judd was also active in administrative affairs of the Baptist Church and of Colgate University. He was President of the Young Peoples Baptist Union of Brooklyn in 1898-99, and a Trustee of the Baptist Educational Society of New York from 1901 until his death. In addition to service as deacon and Sunday School superintendent of his own church, First Baptist of Williamsburgh and later Emmanuel Baptist, he served as Treasurer of the Baptist State Convention of New York (1906-25), Treasurer of the Northern Baptist Convention (1926-36), and President of the Baptist Church Extension Society of Brooklyn and Long Island (1924-40). Colgate University elected him a trustee in 1923. He served on the Board until 1946, and continued as a Trustee emeritus to his death in 1954.

Mrs. Judd, the former Bertha Grimmel, whom he married in Brooklyn, New York, on October 4, 1905, was also active in Baptist and interdenominational church affairs. She died in 1947. They had three children, two of whom died during the influenza epidemic of 1918-19, after World War I. A son, Orrin G. Judd, who survived, was Solicitor General of New York State from 1913 to 1946, is the author of articles and legislation on trust accounting, and is currently a member of the law firm of Goldstein, Judd & Gurfein.





# New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

## Taxing the Nonresident

A resident of the state is taxable on all of his income from all sources. The nonresident is taxable on income earned within the state, which means income from all property in the state and from every business, profession, or occupation carried on within the state. Since the resident is taxed on income from all sources, he may take all permissible deductions without restriction as to whether the expenditure is incurred within the state or without the state. Not so in the case of a nonresident. As to him the deduction must be connected with income from sources within the state and taxable to the nonresident. A nonresident may deduct contributions made to charitable, educational and other deductions if the latter are organized or operated under the laws of this state. The deduction for alimony payments is allowed to a nonresident

provided the wife who receives the payments is subject to tax on them.

Interest paid or accrued is deductible by a nonresident provided the payments are in connection with taxable income from New York sources. So interest on a mortgage on his residence is not allowed as a deduction to a nonresident, even if his entire income is derived from sources within the state. That is so for the reason that such interest is not "connected with income arising from sources within the state." If a nonresident enters into a transaction for profit, a loss is deductible only if the transaction involves real property or tangible personal property having an actual situs within the state. The same is true with respect to losses arising from fire, storm, shipwreck or other casualty or theft. However, a nonresident is allowed an optional, standard deduction.

The problem of taxing a nonresident equitably may lead to results that the nonresident may consider inequitable. Take the case of a resident who carries on a business in New York and then moves to another state. Because of the limitations now placed upon his allowable deductions he may actually pay a larger tax on his New York income than he did when he was a resident of the state. However, if he should be in receipt of income from intangible property, such as dividends on stocks, even if they are those of a New York corporation and even if the stocks are physically located in New York, those dividends are not subject to tax by New York. The stocks are deemed to have a situs at the domicile of the nonresident and so the income is not from New York sources.

BENJAMIN HARROW, C.P.A., has been a member of our Society since 1928, and a member of the American Institute of Accountants since 1922. He is a member of the New York Bar and Professor of Law at St. John's University.

Mr. Harrow is a past Vice-President of the Society. He is a past Chairman of the Committee on Publications and of the Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

### Liability for Tax after Dissolution

A corporation generally ceases to be liable for the franchise tax after it dissolves. Suppose such a New York corporation dissolves in 1956 and an audit of its federal returns for prior years discloses additional income taxes due. Normally such changes in net income must be reported to the State Tax Commission and usually they may result in additional franchise taxes. If the corporation is no longer in existence and the assets have been distributed, how can the state collect any additional franchise taxes? Is there any obligation upon anyone to report the changes in net income and to pay the tax?

Before a corporation is permitted to dissolve it is required to file an application for consent to dissolution (Form 1001). This form requires answers to some pertinent questions. Question 8 reads as follows: "Set forth the amount of net income as determined by final audit made by United States Treasury Department for any year or period begun after July 31, 1933. If no change, so state." The answer to this question enables the Tax Commission to determine whether corrected franchise tax returns have been filed for all years audited by the Treasury Department.

As to years for which returns have not been audited, the next question (9) is relevant: "If a final audit has not been made by the United States Treasury Department, have the directors of this company, either as directors or trustees, set up proper reserve funds to pay any additional assessment of income taxes or franchise taxes which may hereafter be made by the federal government or the State of New York? State amount of such reserve \$ . . . .". The Tax Commission is in a position to require adequate security for the payment of possible taxes.

But there are other procedures that the Tax Commission may follow to collect any taxes due after the corporation has dissolved. It may proceed against transferees of corporate property. Form 1001 asks the corporation to give the names and addresses of stockholders owning 10% or more of the stock entitling them to share in the liquidating dividends and also the number of shares held by each stockholder at the time liquidation was commenced. Another question asks for the names and addresses of the directors of the company.

### Gross Receipts Tax—Mistake of Law

A startling decision in the Appellate Division<sup>1</sup> holds out hope for the taxpayer who pays a tax under a mistake of law and without protest, and then seeks to recover the tax. In this case the taxpayer included in the tax base transactions in foreign commerce, unaware that they were not subject to tax. A year later the taxpayer realized the error and applied to the Comptroller for a refund of the overpayment.

The Administrative Code provides that for a tax to be refunded it must be paid under protest in writing. Obviously that had not been done, since the taxpayer did not realize when he paid the tax that he was not liable for it. The Comptroller denied the application for refund, and the court adds, "although concededly the City was not entitled to any tax." The Code provides that the exclusive remedy for a determination of the Comptroller is a proceeding under Article 78 of the C.P.A. to review such determination. Instead of following that procedure the taxpayer brought a plenary action in the Supreme Court to recover for money had and received. The taxpayer alleged that the City had been unjustly enriched by retention of a payment made in error.

<sup>1</sup> *Mercury Machine Importing Corp. v. City of New York*, reversing 208 Misc. 1063 (1955).

App. Div., 1st Dept., March 29, 1956,

The court held that a prescribed procedure is not exclusive if jurisdiction of the taxing officer is challenged on the ground that the statute is unconstitutional, or where "the statute by its own terms does not apply in a given case." The prescribed procedure would have been futile. It is intolerable said the court "that a governmental body by setting up conditions nearly impossible of fulfillment can confer virtual immunity upon itself, free from any claims of unjust enrichment . . . ."

The City argued that lack of protest was in effect a waiver of a right to claim a refund and that it indicated a voluntary payment. To this the court replied that "there can be no waiver without conscious knowledge of the rights being intentionally waived."

The City also contended that the Comptroller's determination after a hearing was *res adjudicata* in the present lawsuit. To this the court said that there was no determination on the merits of the case. All that the Comptroller had determined was that there was no protest and that the payment was made under a mistake of law.

The final argument of the City was that even in a plenary suit, there can be no recovery for a payment made under a mistake of law but only where there had been a mistake of fact. Here the court pointed to Section 112-f of the Civil Practice Act<sup>2</sup> enacted in 1942 which provides that "relief shall not be denied merely because the mistake is one of law rather than one of fact." The court tries to distinguish the *Egyptian Lacquer Mfg. Co.* case<sup>3</sup>, which denied relief on facts somewhat similar to the instant case. In our opinion the cases are not distinguishable and it may be that the court is seeking a way to overrule its earlier opinion. The court tries to limit its decision to the proposition that "in a plenary suit to recover for mistakes, the distinction between mistake of law and mistake of fact is wholly immaterial." That is really all the taxpayer argued for. Undoubtedly the City will appeal the case to the Court of Appeals. The reasoning of the court is so sound that, in our opinion, the Court of Appeals will affirm the decision. That will be a boon to taxpayers caught in a trap for the unwary.

<sup>2</sup> See citations and our comment, *The New York Certified Public Accountant*, Vol. XXIV, No. 11 (November, 1954), p. 708.  
<sup>3</sup> 285 App. Div. 940.



# Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, C.P.A.

## Controlling Federal Income Tax Changes Reportable to New York State Tax Department

New York State tax laws require that changes in federal income tax affecting New York taxpayers be reported to the State Tax Department within a stated time period. Failure to report an assessment may result in a penalty and the State Tax Department has ways of learning, independently, the changes that have been made. Accountants have a role to play in making certain that "change" returns are timely filed. What are the control mechanics?

Several control possibilities exist, but all involve a follow-up system. As soon as a tax examination is scheduled, the taxpayer's name could be recorded on a tickler. The tickler could be a card record form or a loose leaf book arranged for chronological entries. Here is the initial and basic control. Each item listed must be disposed of and the entries must be reviewed at regular intervals to spot items that are unreasonably old.

If the Internal Revenue Service report is to be sent to the taxpayer, it is

vital that the accountant obtain access to it, either the original or a duplicate. This requires notice to the client which, preferably, should be in written form. Upon receipt of the final report, the accountant is in a position to prepare the "change" report and thereby dispose of the first responsibility. Follow-up, thereafter, can parallel the procedures used by a firm with respect to income tax returns, with particular attention to situations involving refunds.

Whenever an accountant transmits to a taxpayer the waiver form indicating agreement to a change, it might be well to attach a typewritten memo (standard form) requesting that the agent's report be sent to the accountant.

If an accountant does not have knowledge of a tax examination he obviously cannot control the disposition of a change form. Where such possibilities exist the client should at least be advised as to that general requirement.

## "Love or Perish" in the Public Accounting Field

Dr. Blanton's non-fiction best seller "Love or Perish" deals with the vital role of love (human kindness and understanding) in the well-being of people, including business and professional men. The reader will be well repaid for the time devoted to this book, both in increased personal contentment and in the good he may do for others. Gifts of this book (Simon and Schuster — \$3.50; paper copy — \$1.00) may be of inestimable benefit to the donees and should earn the gratitude of many of them.

The opening paragraph discloses the book's objective, to wit:

"Whatever you do in life, do with love!"

MAX BLOCK, C.P.A. (N.Y., Pa.) is a former chairman of the Committee on Administration of Accountant's Practice of the New York State Society of Certified Public Accountants. He is a lecturer at The City College of New York in the graduate course on Accounting Practice. Mr. Block is a member of the firm of Anchin, Block & Anchin.

We have no alternative save to act from motives of hate—yet how doleful to make this our choice! For hate is the destroyer of life, where love is its guardian. Hate blinds our vision and warps our talents; but love releases our energies for the creative action that sustains mankind. While all human behavior springs from a mixture of both these great forces of nature, it is within our power to determine which shall prevail as we journey through life."

Relating the foregoing concept to the business world, Dr. Blanton further remarks as follows:

"Our contemporary industrial society, far from encouraging the fusion of love with aggression, tends to place a premium upon their separation. It insists that 'sentiment has no place' in business, which is another way of saying that love must be eliminated from it. Businessmen go further and maintain that the economic world is a jungle ruled by the law of 'kill or be killed.' Even when they are moved by a loving attitude toward their work, they are ashamed to acknowledge it for fear it will be interpreted as a sign of weakness. They feel they can prove their competence only if they act in a driving and ruthless manner toward competitor, associate and employee alike. Their goal becomes exclusively one of beating the other fellow, of winning ever more power and money.

"Such a view seeks to divide life into separate parts. It makes work primarily a channel for aggression, and reserves the rewards of love for moments of relaxation and leisure. But life cannot be so compartmentalized. Life is all of one piece. Men err when they think they can be inhuman exploiters in their business life, and loving husbands and fathers at home. For achievement without love is a cold and tight-lipped murderer of human happiness everywhere. It produces only things and never human bonds. Since it thrives by releasing the cruel forces of aggression, it can breed only guilt and hate in return. Ultimately it strikes down the businessman himself with heart attacks, or nephritis, or paralyzing depressions while he is still young. And usually its destructive effects also engulf those whom we would love.

"This is not to say that men must renounce their aggressive drives entirely. On the contrary, such an attempt would be foolish in the extreme for it would deprive us of the dynamo that supplies our energy in the first place. The man who tries to live by love alone exposes himself

to annihilation by all the hostile forces that nature itself has planted on earth. . . . It is a matter of balance between the forces of love and aggression not their mutual exclusion."

The foregoing remarks are, at least to some extent, exaggerated for the purpose of emphasis. All of us surely know men who have learned to achieve a mature balance between the forces of love and aggression. But we also know many who have not. Insofar as we act as counsellors to our clients we have an opportunity to point out shortcomings that affect not alone the businessman's well-being but the morale and development of his organization and perhaps even its profitability. Personal conduct in business is properly within the sphere of business management guidance, and accountants need not feel that they are invading a foreign area. Personal conduct is patently a very delicate subject and it must be dealt with most discreetly and understandingly. Accountants can perform a social good by their effective actions in this sphere.

Moreover, Dr. Blanton's exhortations are applicable to accountants in the conduct of their own lives and professional practices. In the office it pertains to our relations with staff, our interest and efforts for their well being, an awareness of their existence, helpfulness with personal problems, satisfactory compensation, good working conditions, and the many other facets of good personal relationship. It extends to the manner in which men are hired and broken in, how they are disciplined, and finally to the manner in which their positions are terminated. Particularly in the matters of discipline and in separation from the organization, the control of our natural aggressive forces are obvious clues to the extent of our own emotional maturity.



# Payroll Tax Notes

Conducted by SAMUEL S. RESS

## Unemployment Insurance—Subsidiary Contributions Payable Except by New Employers Commencing January 1, 1957

An additional tax of three-tenths of one percent on top of their regular rate for unemployment insurance will have to be paid by all employers covered by the New York law with the exception of those employers who became subject to the law for the first time after September 30, 1955. The increase for the coming year was announced by the Industrial Commissioner, Isador Lubin, who pointed out that the raise is required under the present law even though the State Unemployment Insurance Fund is in a healthy condition with a balance of one and a quarter billion dollars.

As was pointed out by the writer in his talk at the Society's technical meeting of the Committee on State Taxation last March, 1956, the rise in the unemployment insurance rate is the result of the failure of passage of a bill introduced into the state legislature for the purpose of postponing the imminent increase until further study of the "General Account" formula in the present law which requires the increase.

SAMUEL S. RESS, an Associate Member of our Society since 1936, is a member of the New York and Massachusetts Bar. He has specialized in the payroll tax field since the inception of this type of legislation in 1936.

Dr. Ress is a member of the Society's Committee on New York State Taxation and Chairman of the Subcommittee on Unemployment Insurance.

A slim possibility remains that the next State Legislature when it convenes in January of 1957, may enact some remedial measure, but that possibility appears to be remote at the present time.

## New Amendments Effective July 1st, 1956

### 1. *Employers' Qualifications for Reduced Rates*

New businesses and some newly covered small employers will have an opportunity to participate in merit rating sooner than heretofore.

Up to now employers have been held to a fixed tax rate of 2.7 percent of payroll until their fifth year of tax liability. The amendment to the statute permits employers with slightly more than one year of experience to qualify for reduction in tax rates under the provisions of the Unemployment Insurance law. It is estimated that there are some 105,000 employers in this state who may qualify for reduced rates because of this amendment commencing January 1, 1957, if they are still in business. Accountants should note this provision for new business clients or newly reorganized old clients who may have been ineligible formerly; under the new law they may be eligible.

In this connection it is interesting to note that out of some 50,000 new firms that come under the law each year, only 23,000 are likely to see their first birthday; 12,650 will last two years; and only 8,475 will survive three years or longer.

## 2. *Changes Affecting Employers' Experience Rating*

Employers generally should benefit from this amendment which provides uniform time limitations of two years for redetermination of an employer's tax rate, regardless of whether the change would raise or lower the rate. Formerly tax rates once calculated could be increased at any time within four years, if error is found in his payroll reports or other record on which the original tax rate was based. They could not be lowered after they were once calculated, prior to this amendment.

Accountants whose clients may now be eligible for more favorable unemployment insurance rates, but were barred formerly, should recheck the present status of pertinent cases and clients' accounts.

## 3. *Stockholders of Corporations on the Payroll*

If a corporation is not subject to the Federal Unemployment Tax Act (it does not employ four or more employees on each of 20 different days during 20 different weeks in a calendar year), it does not have to pay the State a tax on the wages of an employee who is a principal stockholder. If it is subject to the Federal Unemployment Tax law, the employer is liable to the State on principal stockholder wages. The law previously defined a principal stockholder as one who owned 25 percent or more of the capital stock of the corporation. The amendment defines capital stock as "voting stock issued and outstanding" and provides that if classes of stock have different voting rights, 25 percent of the voting stock means 25 percent of the vote represented by all issued and outstanding voting stock.

## Governor's Memorandum on Preservation of Business Records

Of special interest to accountants and clients plagued with the constant accumulation of records and the scarcity of file space, is the Governor's veto message of the bill which passed the Legislature so as to permit the destruction of business records after three years unless otherwise required by law. It also would have permitted reproductions of records to be kept in lieu of originals. The Governor stated:

"Sound business practice would seem to dictate the retention of records for a substantially longer period than that provided for by this measure. Furthermore, since the Statute of Limitations, prescribing the period within which a lawsuit may be instituted, exceeds this period in many instances, legal sanction for doing away with records that are three years old could have unfortunate and unintended results. Nor would the substitution of reproductions, where records are required to be kept for stated periods, serve any good purpose unless the originals are required to be preserved for any substantial time.

"Authenticity when disputed, can usually be best determined by study of the original document or record; the stroke of a pen, nature and quality of ink, the age of the script—these, among other factors, lend themselves to analysis which is defied by even a good microfilm, photostat or other reproduction.

"These objections to a bill which, obviously, is intended to effect economies of space and effort in the keeping of business records preclude its approval."

## Salesmen's Wage Payment Law

In 1955, the Labor Law was amended to require payments to salesmen of their wages, drawing accounts, and commissions at least once a month. Problems arose in connection with the payment of incentive earnings, bonuses, and special payments calculated upon periods longer than a month. This amendment to the law permits incentive wage plans if monthly payments are substantial.

## Coverage of Office Workers Under Wage Provisions of the Labor Law

An amendment to the New York State Labor law now affords the protection



of the State Labor Department's enforcement facilities to office workers who are not considered executives earning over \$100 a week. Formerly the labor law only protected wage claims of factory and other non-white collar employees.

**Supplementary Unemployment Benefits Are Subject to Federal Income Tax**

The Commissioner of Internal Revenue has ruled that while the supplementary unemployment benefits receivable under the recently negotiated contracts between the employers in the automotive industry and the Automobile and Aircraft Workers Union of the AFL-CIO, will not be treated as wages subject to withholding, social security, and federal unemployment taxes, the recipients of these benefits will be required to report such sums collected by them as non-wage income on individual income tax returns filed annually. The Internal Revenue service has held however that unemployment insurance benefits received by unemployed claimants from state unemployment insurance funds are not taxable income to the recipient.

**Bank Errs in Defining "Employee", Billed for Jobless Tax from '47**

Failure to recognize that its part-time cleaning woman was an "employee" rather than an independent contractor has cost a small upstate bank \$615 in back unemployment insurance taxes and \$363 in accumulated interest. The tax liability of the bank has been sustained by the Appellate Division of the State Supreme Court.

Commenting on the significance of the Court ruling, Richard C. Brockway, Executive Director of the State Labor Department's Division of Employment, cautioned that part-time or casual employment will undoubtedly bring many

small firms under the law this year now that the test of liability is employment of three workers on even a single day. He urged firms in doubt about their status to write to the Division's headquarters office at 800 North Pearl Street, Albany, for a "Report to Determine Liability" form.

Failure to recognize its liability, Mr. Brockway pointed out, could cost a firm as much as six years in back unemployment insurance taxes plus 9% annual interest on the unpaid balance.

**Lubin Clarifies Rules on Job Insurance During Plant Closings for Vacation**

After examination of the individual management-labor contracts of several hundred business firms that plan vacation shutdowns, Industrial Commissioner Isador Lubin recently announced the rules which will apply if affected employees looking for jobs seek unemployment insurance. In order to remove any misunderstanding, the rules extend and clarify policy announced in May.

Examination of the individual contracts was necessary, Mr. Lubin said, because of a decision by the Appellate Division of the State Supreme Court (*Matter of Dresher*) handed down last November. The Appellate Division held that a "vacation allowance" received as a matter of fixed contract right unrelated to a vacation period, could not be considered pay for the vacation period.

Pointing out that the Department of Labor policy which he adopted in June, 1955, on unanimous recommendation of the management, labor and public members of the State Advisory Council on Employment and Unemployment Insurance is still the basic determinant of whether a worker is entitled to unemployment insurance during a vacation period, Mr. Lubin said the examination

showed that there are two types of contract which provide for vacation allowances as a fixed right: (1) those that provide only for the payment and have no provisions at all for a vacation period; and (2) those which provide not only for vacation allowance but also for vacation period.

Study of the contracts and conferences with management and labor concerning the intent of their contracts have led to the conclusion, in conformity with the Departmental policy, that under the second type of contract the allowance is in fact pay for the vacation period.

The following rules will therefore apply, he said:

1. Where a union expressly consents to plant shutdown or curtailment of operations for vacation purposes, all employees are presumed to be vacationing and to be out of the labor market. No one, paid or unpaid—even though he may actually be looking for temporary or other permanent work—will be entitled to benefits during the agreed shutdown period. This principle was established in previous court decisions.

2. Where a contract provides for paid vacation, or provides separately for a vacation allowance and for a vacation period, and there is a plant shutdown or curtailment for a vacation period without express union consent, employees entitled to vacation allowance are not entitled to unemployment insurance—even though they are looking for work. If an employee not entitled to a vacation allowance applies for benefits,

the facts will be examined. If he is in fact vacationing he will not be entitled to benefits. If he is not vacationing but is looking for work, his claim will be accepted.

3. Where a contract provides for a fixed-right "vacation allowance" but makes no reference to a vacation period, each case will be examined if there is a vacation layoff and benefit claims are filed. If the claimant is in fact vacationing, taking a temporary respite from work, he will of course not be entitled to unemployment insurance. If he is not vacationing, but is actively looking for work, his claim for benefits will be accepted. In this type of case the money he receives may be called a "vacation allowance" but it has been held by the court to be a bonus for past services and not payment for a respite from work.

Basic principles and long-standing rules on other vacation arrangements are unchanged, Mr. Lubin said:

a. To be eligible for unemployment insurance a claimant must be unemployed and seeking work.

b. Persons who are vacationing are not seeking work and are not entitled to benefits.

c. If individual vacations are staggered and there is no shutdown or curtailment of operations, individual employees who take vacations—paid or unpaid—are considered to have taken them voluntarily. They are presumed to be vacationing and are not entitled to benefits.



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# Official Decisions and Releases

## Does The CPA Examination Create A Monopoly?

The old argument that CPAs are trying to run a "closed shop" still crops up every legislative season. The fallacies of the charge can be easily demonstrated, but the public relations aspects of the problem are more complex.

While much of this material in this article has been circulated in one form or another for years, it is felt that if every CPA had at his fingertips a brief statement of the facts and figures necessary to counter the monopoly charge, he could better present an undistorted version of the profession's story to educators, bankers, businessmen, legislators, and the general public.

It is often charged that the uniform CPA examination is deliberately made difficult in order to restrict entrance to the accounting profession and to create a monopoly for CPAs.

This charge can be readily refuted by a consideration of the facts. These reveal that the examination is not too hard, and that, far from restricting entrance to the profession, CPAs have done all they could to encourage young people to enter the field of public accounting.

### The CPA Examination

Critics support their claim that the examination is more difficult than necessary by pointing to the relatively low percentage of successful candidates. The real reason for the large number of failures, however, is that most states allow high school graduates to sit for the examination, and many of the candidates are poorly qualified. This situation contrasts sharply with the medical profession, for example, where an M.D. degree is a prerequisite for the granting of permission to practice.

The preparation and distribution of this article was authorized by the Committee on State Legislation of the American Institute of Accountants.

An impartial view of the CPA examination was expressed by Friedman and Kuznets in a survey called, "Income from Independent Professional Practice" published by the National Bureau of Economic Research in 1945:

"The absence of concerted effort to restrict entry on grounds of 'overcrowding' might conceivably be combined with, and explained by, the presence of highly successful restricted measures. In fact, however, there seems to have been no deliberate restriction of entry. The very low proportion passing examinations for the certificate . . . is rather to be explained by the absence of high educational or training requirements for admission to the examination."

Viewed in another light, the low passing percentage may not be so low as it seems. There are many repeaters in each examination; and in most states a candidate passing some sections of the examination receives credit for those he passes and may try again six months or a year later on the subject or subjects he failed. Consequently, the percentage of candidates who are finally certified is much higher than the proportion who receive the certificate as a result of any single examination.

Unfortunately, figures that would show the percentage of those who ultimately pass the examination are not available on the national scale. But the figures for Michigan are probably typi-

## Official Decisions and Releases

cal. In 1949, George D. Bailey, past president of the American Institute of Accountants, announced in a public hearing before a Michigan legislative committee that of the 708 who had sat for the examination in the eleven previous years, 393 or 61% had passed. Mr. Bailey continued:

"Another 185, many of whom have passed in two or more subjects, are still taking the examination. We can expect that 80% of all candidates will eventually be certified. It is not a low percentage. Many pass the first time; others the second or third. Only 103 people have dropped out—some because they left the state, others because they lost interest in public accounting.

"Now I don't remember a man who acquired his experience with me who did not eventually get his certificate—if he really wanted it. Firms are always trying to help their men pass. I have seen men still in their junior year in college pass all of this examination on the first attempt. Of course, they can't get their degree until they get adequate experience. But when college juniors can pass the examination—and they are not isolated cases but a substantial number—then it really isn't too hard."

In March, 1954, Mr. Russell C. Harrington, now Commissioner of Internal Revenue, spoke at a public hearing before the Rhode Island Senate Judiciary Committee. The following excerpts from his talk demonstrate the need for maintaining the high standards of the CPA examination:

"The practice of accountancy is a professional function, which intimately affects the public interest. Business management, stockholders, credit analysts, banks and other financial institutions, legislators, government bureaus—all must depend on certified financial reports.

"It is of the greatest importance, therefore, that the laws which govern the practice of public accountancy maintain the high professional standards which now prevail.

"The CPA examination is a uniform examination, prepared by the American Institute of Accountants, given simultaneously in all states and territories. This uniformity makes it possible for each state to recognize the certificates issued by another.

"The justification, upheld in many court decisions, for the existing laws which provide almost identical standards for certified public accountants is that the public can rely on a CPA certificate as a proof of demonstrated competence. The whole tendency of the public has been to expect higher standards, rather than lower."

### Encouraging Entrance to the Profession

Certified public accountants constitute the world's fastest growing profession. Their numbers have increased from 1,712 in 1910 to over 54,000 today. Since 1930 the number of CPAs has quadrupled. Despite this astonishing growth, the demand for the services of CPAs has increased faster than the supply. CPAs, through their national organization and state societies, have consistently encouraged entrance into the profession, and assisted in the development of educational facilities for accountants, as well as in the training of those who have adopted public practice as a career. They have always cooperated with schools and colleges where accounting is taught.

The American Institute of Accountants has distributed to students and potential students of accounting thousands of personnel pamphlets. Among these might be mentioned the 24-page booklet "Accounting May be the Right Field for You" and the 76-page pamphlet "Information for CPA Candidates."

At a cost of over \$35,000, the Institute has produced a career film, "Accounting—The Language of Business," which should do much toward alleviating the personnel shortage.

In a further effort not only to attract students but to provide a means by which they can determine whether accounting would be a suitable career, the Institute has sponsored a \$125,000 project to develop standard tests for students and junior accountants. This project resulted in a series of tests of aptitude, interest and achievement. The

tests have been thoroughly verified and are widely used. During the eight-year period from 1946-54, about 230,000 tests were administered in some 400 colleges and universities.

All that has been done by the Institute has been done also at the local and state levels. The record of the efforts of the state societies, their local chapters and individual members to make the profession attractive to the best of the stream of young men and women who graduate into the business and professional life of the country each year, and to encourage and help to full professional stature those who have joined the profession, is one that would command the admiration of the most skeptical.

One of the most noteworthy of these activities has been teaching. Since accounting is a relatively new profession, there never has been an adequate supply of experienced teachers. As a result, a large part of the profession is self-taught; in every state practicing CPAs have borne a large share of the responsibility for teaching many of those who now constitute the profession.

It simply is not true, therefore, when anyone says or implies that the CPAs are trying to run a closed shop. On the contrary, no individual, group of individuals, or organization has been nearly so conscious of the profession's needs, or done as much to satisfy those needs, as have the accountants themselves.

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**TWENTY-FIRST ANNUAL REPORT**  
**of the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**(Fiscal Year Ended June 30, 1955)**

**Section Dealing with the Activities of the Commission in Accounting and Auditing**

Recognizing the importance to investors of dependable financial statements which disclose the financial status and earnings history and potentialities of a corporation or other commercial entity, the various Acts administered by the Commission deal extensively with financial statement presentation and the accounting concepts and principles upon which they are based. These Acts grant the Commission broad authority to prescribe, among other matters, the form and content of financial statements required to be filed by registrants subject to the Securities Act of 1933 and the Securities Exchange Act of 1934, to prescribe uniform systems of accounts for companies subject to the Public Utility

Holding Company Act of 1935, and to provide for a reasonable degree of uniformity in accounting principles and policies to be followed by registered investment companies in maintaining their accounting records and in preparing financial statements required by the Investment Company Act of 1940.

The principal accounting requirements prescribed by the Commission under these Acts are contained in Regulation S-X, which governs the form and content of most financial statements required to be filed with the Commission. Implementing this regulation are 77 Accounting Series Releases which have been issued from time to time since 1937 for the purpose of contributing to

the development of uniform standards and practice in major accounting questions. In addition, uniform systems of accounts have been prescribed for certain public utility holding companies and for public utility mutual and subsidiary service companies, and, under the Securities Exchange Act, rules have been adopted governing record keeping, financial reporting, and the auditing of the books and records of exchange members, brokers and dealers.

These requirements, except for the uniform systems of accounts, pertain to the accounting to be followed only in certain basic respects, and in those areas not covered reliance for the protection of investors is placed upon the determination and application of accounting principles and standards which are recognized as sound and which have attained general acceptance.

The various Acts also give recognition to the desirability of obtaining independent review of financial statements made available to investors or prospective investors through filing with the Commission, and the Commission requires that such statements be certified by independent public accountants. The Commission's standards of independence are stated in rules 2-01 (b) and (c) of Regulation S-X which provide among other things that an accountant will not be considered independent with respect to any person, or any affiliate thereof, in whom he has any financial interest, direct or indirect, or with whom he is connected as a promoter, underwriter, voting trustee, director, officer, or employee. In determining whether an accountant is in fact independent with respect to a particular registrant, the Commission will give appropriate

consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that registrant or any affiliate thereof.

In order that the Commission may be kept informed as to whether financial statements filed with the Commission are based upon sound and generally accepted accounting principles the Commission's accounting staff engages in continuing study and research. These activities, primary responsibility for which rests with the Chief Accountant of the Commission, require close contact and cooperation between the staff and accountants both individually and through such representative groups as, among others, the American Accounting Association, the American Institute of Accountants, the Controllers Institute of America, the American Petroleum Institute, the National Association of Railroad and Utilities Commissioners, and the National Federation of Financial Analysts Societies, as well as with other governmental agencies. During the year matters which required consideration and discussion with one or more of these groups included the appropriate accounting for corporate mergers and acquisitions; the effect accounting-wise of the repeal of section 452 of the Internal Revenue Act of 1954 which permits the deferment, until earned, of income collected in advance, and section 462 which provides for deductions for certain reserve provisions (e. g., cash and quantity discounts, vacation pay, product guarantees) in lieu of actual expenditures therefor; and the requirement of filing of semi-annual income and surplus statements.\*

\* See Securities Act release No. 5189 (June 23, 1955).



# Correspondence

To the Editor of *The New York Certified Public Accountant*:

The finest machinery which our Society can provide to assist in the transfer of one's practice at his death will be valueless unless both Executor and family have knowledge that such assistance is available. It is suggested, therefore, that a simple memorandum, such as the following, be prepared, signed and dated, and then filed by each member with his Will:

"Inasmuch as I have no partners and have not made any arrangement for the transfer of my practice at my death, I request that my executor and/or the attorney for my estate communicate immediately with the Emergency Committee of the (fill in) Chapter of the New York State Society of Certified Public Accountants or with the Society's Committee on Problems of the Individual Practitioner, which committees may be called upon for assistance in such matters.

Experience has shown that delay in effecting transfers is costly because professional practices disintegrate when clients do not know that a transfer is imminent. This has an adverse effect on the value and the amount which may be realized from a timely transfer.

The person to whom the request for advisory assistance should be addressed is: (furnish name, address and telephone number)

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(Date)

....."  
(Signature)

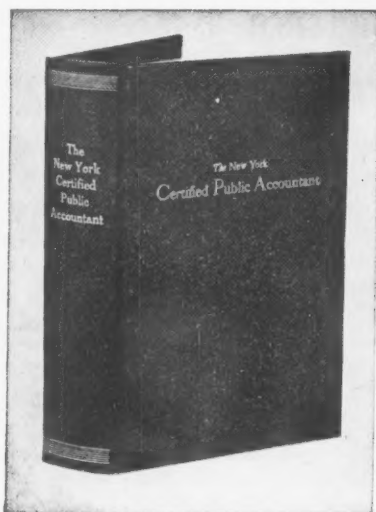
Of course, proper provision must be made in the Will by your attorney to implement the carrying out of any such arrangement.

Yours very truly,

ALBERT KRAUTER

Chairman, Committee on Problems  
of the Individual Practitioner





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